

**Country Study for Japan's Official  
Development Assistance  
to Mongolia**

**March 1997**

**The Committee on the Country Study  
for Japan's Development Assistance to Mongolia**

**Organized by  
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## Preface

In June 1996, the Japan International Cooperation Agency (JICA) organized a Study Committee on Development Assistance to Mongolia (the Committee) and commissioned it with the task of considering Japan's strategy for development assistance to the country. This is an English translation of the report prepared by the Committee, presenting its recommendations as well as its assessment of Mongolia's current political and economic situation, its problems and future prospects.

Mongolia is currently in the midst of transition from a socialist regime, which lasted for nearly 70 years, to a parliamentary democracy and market economy. The process of transition entails special difficulties for Mongolia. At the beginning of the 1990s, Mongolia's economy had developed into an integral part of the economic and trading system of the now defunct CMEA countries, and had depended on regular, large inflows of economic assistance from the former Soviet Union. It was a command economy based on central planning, with socialized ownership of almost all means of production down to nomadic livestock. The transition requires that the Mongolian economy adapt itself to the new international economic environment in which it is now situated; that it should develop new economic policy regimes and institutions necessary for the working of market economy, and that it should efficiently manage them. For Mongolia, the transition is proving to be an unprecedented and difficult process — a venture into uncharted waters.

From the beginning of the 1990s to date, Mongolia seems to have overcome the initial difficulties and disorder of transition, aided by strong stabilization policies and infusions of sizable international economic assistance. It now seems clear that the phase during which stabilization efforts had to be accorded top policy priority have passed. The major tasks facing the Mongolian economy over the coming years will be structural reforms and institution-building as well as the recovery and restoration of growth of the economy. We are aware that, given its geography — no direct access to international waters and extremely severe natural and climatic conditions — Mongolia can hardly expect to attain rapid economy growth such

as experienced by many East Asian economies, despite the fact that the country has successfully made the transition to a functioning market economy. Looking beyond the transition phase, the difficult task of great importance yet to be carried out is to develop a long-term vision of a viable and growing Mongolian economy and an effective strategy for attaining it.

Japan has been providing Mongolia with multifaceted development assistance on a large scale relative to the size of Mongolia's economy as well as compared to that provided by other major industrial countries and international development organizations. We fully endorse the view that Japan should continue to do so and make recommendations as to where emphasis should be placed within the various areas of the economy. Our fundamental position, from which we have derived these recommendations, is that, for the time being, Japan's development assistance strategy should, as a matter of top priority, aim at helping Mongolia to overcome a number of major difficulties in the transition to a market economy. In this respect, we believe it to be of paramount importance to help develop and complement Mongolia's human resources, in particular, the managerial and technical manpower required for leading, managing and operating the new market economy.

We, the members of the Study Committee, would feel highly rewarded if our recommendations as well as our assessments of Mongolia's prospects and problems contained in the report could contribute, even in a small way, toward a fruitful policy dialogue between Japan's policy makers and agencies and the government of Mongolia and, through such a dialogue, toward the formulation of an effective assistance strategy for the country.

The Study Committee consisted of nine members drawn from among academicians specializing in Mongolian studies and development economics, working together with the staff of the Overseas Economic Cooperation Fund (OECF) of Japan and JICA Development Specialists. In addition, two JICA Development Specialists took the role of advisers to the Committee. The Committee held five meetings with the attendance of several staff members of the Ministry of Foreign Affairs and JICA, as well as staff members of the JICA Study Committee Secretariat, specifically established to assist the

Committee. The meetings discussed, among other things, the current situation, problems and prospects of Mongolia's economy, with a view to formulate the Committee's recommendations on Japan's assistance strategy for the country. Each member and adviser contributed to the section of the report dealing with the area of his or her responsibility, drawing on the discussions of the plenary meetings.

In the capacity of Chairperson of the Committee, I would like to thank my colleagues who shared invaluable data, information and research findings with the Committee and who managed to find time for writing their respective contributions to the report. Thanks are also due to several JICA experts currently on assignment in Mongolia who took the trouble to obtain the latest information and statistics from Mongolian sources. I would also like to thank the staff of the Japanese Embassy in Ulaanbaatar; the office of JOCV Mongolia; those JICA experts on assignment in Mongolia who provided extensive assistance to the Chairperson and several staff members of the Study Committee Secretariat when they visited Ulaanbaatar in August/September 1996, arranging meetings with Mongolian government officials, providing valuable information and offering expert views and advice; Mongolian government officials who took the trouble to provide the visiting work team with useful and beneficial information and opinions; and the staff of the China and Mongolia Department of the World Bank who provided valuable documents and opinions for the Committee. Finally, on behalf of all members and advisers of the Committee, I would like to express my special thanks to the staff of the Institute for International Cooperation, JICA and, in particular, to the staff of the Study Committee Secretariat who assisted the working of the Committee in all conceivable ways.

March 1997

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## Summary

### 1. Political and Economic Trends in Mongolia

Mongolia is currently in the midst of a structural transition aimed at casting off its old socialist system and building a parliamentary democracy based upon a market economy. Modeled on the Soviet *perestroika* policy shift of the mid-1980s, political reforms in Mongolia began primarily as a drive to rebuild the economy. Gradually, though, they began to assume a politicized dimension, and ultimately evolved into a full-fledged democratization movement. In 1990, Mongolia brought to an end the era of one-party rule by the Mongolian People's Revolutionary Party (MPRP), and in 1992 unveiled a new constitution that abandoned socialism and changed the country's name. General elections in June 1996 handed the Democratic Union coalition an overwhelming majority of the seats in the Great Khural (the single-chamber parliament), effectively completing the transition to a new political system. As a result, Mongolia's foreign relations posture shed its deep-seated dependence on the former Soviet Union and shifted toward a policy of nonalignment shaped by balanced relations with Russia and China as well as with the U.S. and other Western powers.

Nonetheless, the structural transition has confronted Mongolia with a number of difficulties and confusion on the economic front. As a socialist country for almost seven decades, Mongolia actually registered comparatively strong economic growth and development up to the beginning of its transition process in the early 1990s. That achievement was matched in the so-called "human development" or social services dimension by admirable advances including education and social welfare. Still, it has to be noted that these accomplishments were products of a heavy dependence on the communist bloc's COMECON (Council for Mutual Economic Assistance) framework for trade and division of labor, not to mention extensive injections of Soviet aid. Unsurprisingly, the Soviet collapse and the scrapping of COMECON dealt the Mongolian economy three heavy blows. First of all, Mongolia lost virtually all the Soviet and East European markets for its industrial goods, as well as the key sources of intermediate and capital goods so essential to the operation of its economy. Secondly, it lost access to Soviet aid, which amounted to as much as 30% of its GDP. And third, it suffered a drain in personnel capable of running its economy when teams of Russian supervisors, engineers, and their dependents packed up and headed back home.

These three blows were moreover compounded by economic strains that Mongolia's own government induced with fast-track policies for transition. These included price decontrol, several currency devaluations, the abandonment of subsidies to all but a few state-owned

enterprises, and a sweeping privatization drive modeled on the East European voucher formula. The combined impact manifested itself in soaring inflation (that at one stage measured 100% in annualized terms) and a cumulative plunge of 20% in GDP between 1990 and 1991.

To deal with the economic turbulence and stagnation brought on by the transition process, Mongolia introduced a set of powerful measures in economic stabilization. By 1991, the economy had largely steadied and begun showing signs of moving into a recovery phase. Based on agreements worked out with the IMF and other multilateral institutions, Mongolia adopted austere fiscal policies and also tightened its monetary policy. Japan, the World Bank, the Asian Development Bank (ADB), the U.S., Germany, the IMF, and other participants in the Mongolian Assistance Group provided vast amounts of financial and technical assistance designed to ease Mongolia's balance-of-payments and fiscal strains. The objective was to furnish support for the country's stabilization policies and assist emergency repair work in areas of energy infrastructure essential to public welfare. Incidentally, over the five-year period from 1990 through 1991, that assistance totaled more than \$500 million (on an approvals basis). This understandably amounts to a relatively large sum, considering that Mongolian nominal GDP measured about \$700 million in 1991.

The stabilization policies and assistance together proved effective in taming runaway inflation, and allowed Mongolia to reverse a downtrend from 1991 in GDP with growth of 2.3% in 1991 and 6.4% the following year. This turnaround in GDP was powered mainly by sectors that had begun expanding after the transition, namely, the gold-mining industry, the commercial trades and other elements of the service sector, and the export-oriented textile industries. In effect, the recovery has not yet spread to all of Mongolia's traditional industrial sectors, except for the livestock sector.

In fact, the transition has had an entirely different impact in the livestock and crop-farming sectors. First of all, steps were taken to put practically all the livestock sector back into private hands. That included breaking up the *negdel*, which were the sector's collective units of production under the former socialist system. Following the transition, demand for livestock and meat products fell; export demand from Russia in particular nose-dived. The declining volume of slaughtered livestock had the effect of dampening the supply of livestock-derived raw materials to the food industry and other, light industrial sectors. In addition, the *negdel*-based distribution frameworks disappeared, and the level of government support to the livestock sector dwindled: e.g., in such areas as the provision of

veterinary services, the construction of livestock shelters and water wells, and the emergency supply of fodder during the winter months.

Nonetheless, the overall impact on livestock output has been relatively light. Though output slackened at one point, in 1995 it was up 10% from its 1990 level. On top of that, the sector itself has fulfilled a buffering role by assimilating a large part of the urban poor and unemployed who had family ties to rural areas.

The crop-farming sector has by contrast been all but devastated by the transition. Output, for instance, dropped by half its 1990 level. The central reason is that this is a relatively new sector initiated by government-run ventures on virgin farmland, and heavily dependent on imports for the supply of practically all essential intermediate and capital goods, including heavy farm machinery, machine parts, fuels, seed, and fertilizer. The steep decline in output is chiefly attributable to difficulties in securing such imports, and an end to government price supports for crop produce and subsidies to state-run farms.

The transportation, shipping, and postal service sectors were all adversely impacted during the transition process, while the telecommunications field demonstrated growth. Combined passenger and cargo volumes in the rail, road, and aviation subsectors peaked in 1988 and then slipped into an incremental decline. In 1995, though, volumes grew marginally, signaling the start of an upturn. However, passenger volume is currently running around two-thirds its former peak, and cargo volume (tonnage), only one-third. There are several reasons for this. One is that demand for transportation and shipping services has fallen in tandem with the net decline in GDP. More importantly it is largely an outcome of the sharp declines in Mongolian import and export volumes. From a supply-side standpoint, the downswings are a manifestation of the difficulty in securing imports of materials and parts essential to the maintenance and development of transportation infrastructure on the one hand, and on the other, a setback in transport capacity due to fuel shortages and a consequent decline in truck operating rates.

Trends in mail volume more or less parallel those in transportation and shipping. The shrinkage in international mail volume has been especially pronounced in cumulative terms. While the deterioration in the economy and trade has affected demand, falling operating rates for postal delivery vehicles have had an adverse impact on the supply side.

By contrast, volume and service quality in the telecommunications sector actually

improved during the transition phase. That achievement was largely attributable to aggressive steps in institutional and structural reform, service-provider privatization through joint-ventures with foreign interests, and aid-backed investments in the international telecommunications sector.

Mining and manufacturing were sectors hurt by the country's structural transition, albeit to a substantially different degree. Though output volumes for the key mineral products--copper concentrate, molybdenum concentrate, and fluorspar--slipped temporarily, as of 1995 all were back up near their 1990 levels. Two additional factors deserve attention: one was firm growth in tin output, and the other, a sharp expansion in gold output thanks to government measures in deregulation that opened the door to private mining interests.

On the other hand, Mongolia's manufacturing sector has since 1990 registered declines in the output of certain items that were important domestic goods under the old COMECON framework: namely, scoured wool, hides and skins, leather and shoes, and sausage and other processed food products. (Cashmere and other wool products, however, have not followed that downtrend.) Weakened domestic consumer demand and shortages in the supply of raw materials and fuels are considered to be the key factors behind these declines. On the brighter side, privatization steps in 1991 spurred the establishment of a number of small-scale businesses, including joint-ventures by booming domestic manufacturers and foreign capital interests. These new ventures are stepping up the output of processed foods, textiles, and other consumer goods for the domestic marketplace.

The transition-induced impact on the energy sector (electricity, steam, coal, oil) was much more severe. In fiscal 1995, electricity output measured 60% of its 1990 level, compared with 90% for steam and 70% for coal. Though these levels appear to be bottoming out, they are still quite low by 1990 standards. Mongolia depended entirely on the former Soviet Union as the source for its imports of petroleum products. Following the collapse of COMECON, oil imports from Russia were cut in half. Steam for heating purposes at one point slipped to around 85% its peak level. Steam heating is an infrastructural essential for life in urban districts during the frigid winter months. The slump in energy supplies briefly reached crisis proportions for the economy and the country's citizens.

Several reasons explained the falloff in energy output. The Soviet engineering personnel assigned to Mongolia's key power stations had all pulled out and gone home. Spare parts and consumables for facility maintenance and repair were in short supply. Finally,

though coal was the principal factor input for the generation of electricity and steam, its quality had deteriorated and it also was in short supply. Actually, there were several factors behind the decline in coal output itself. They ranged from a lack of parts for equipment repairs and replacements to frequent breakdowns in heavy excavating equipment that in turn derived from a scarcity of trained maintenance personnel.

Recognizing the importance of energy supplies in Mongolia, Japan, the U.S., and Germany, together with other leading donor nations and institutions, supplied the country with an emergency package of aid concentrated in the energy field. This is the reason the declines in energy output appear to be leveling off now. However, the shortages in those forms of energy essential to economic infrastructure--particularly electric power--remain unresolved, and crisis conditions still prevail. The 1994 and 1995 surges in electricity imports from Russia essentially testify to that fact.

Fiscal revenues shrank during the transition process. To stabilize the economy, Mongolia had no choice but to curb fiscal spending. That meant cuts in government outlays for education, health care, and other basic social services, and a concomitant deterioration in the quality and scale of such services. During its socialist era, Mongolia built an elementary and secondary educational system based on generous expenditures and policies that placed priority on social development. That enabled it to provide close to 100% of the school-age population with opportunities for education, and in turn achieve high literacy rates despite the tough conditions posed by a largely nomadic population spread thinly over a vast national territory. In the health sector, the government succeeded in providing free medical services to 90% of the population.

However, social services in general have deteriorated since the start of the transition process. The cuts in government educational outlays have hampered the task of retraining teachers and preparing textbooks for the new political and economic realities. Individual students are now responsible for the dormitory fees previously borne by state enterprises or *negdel*. In addition, climbing demand for child labor in nomadic households has driven the average student dropout rate above 12% nationwide. These developments, coupled with the deterioration in schoolteacher wages, have thrown the entire educational system into disarray.

In the meantime, cuts in health care spending have prompted the introduction of a system whereby patients themselves must pay part of the bill. Furthermore, due to budget

shortfalls in general, health and medical care facilities and equipment have deteriorated, medicines have become increasingly scarce, and health care professionals must tolerate lower pay. As a result, rural health care services in particular have been hurt in terms of their quality and scale, and are not capable of dealing with the growing ranks of the poor.

These economic conditions, together with declining output in the agricultural, manufacturing, construction, and transportation sectors, and shrinkage of the government sector, manifested themselves as a sharp increase in the number of unemployed. Some of those unemployed have been re-assimilated by livestock breeding operations in their home districts. Others have been assimilated into booming subsectors of the "informal" commercial and service trades. Though the official unemployment rate (for registered workers) measured 8.7% in 1994, by 1995 it had fallen to the 5% level. However, the actual unemployment rate is conceivably much larger than the official estimate if calculations account for temporary layoffs by state-owned enterprises and unemployed job-seekers who as yet have no work record. It has been reported that an increasing percentage of the unemployed, female-headed households, and nomadic households with only a few head of livestock, now live below the poverty line. By government estimates, one-fourth of the entire population was living below the poverty line as of mid-1994. Clearly, poverty has emerged as a grave social problem in Mongolia.

## **2. The Development Outlook**

Mongolia has registered a measure of success with the stabilization policies it implemented to deal with conditions of economic stagnation and upheaval provoked by the transition process. The time for according stabilization top priority is almost over. Structural reform, recovery, and renewed growth will be the prime challenges on the economic front over the next few years. Considering Mongolia's current circumstances, it seems unreasonable to expect it to post a firm recovery or rapid growth any time soon.

The COMECON framework and heavy infusions of aid from the former Soviet Union can be largely credited for the stage of economic development Mongolia had reached by the beginning of 1990. Currently, though, Mongolia's long-term prospects for continued economic development seem uncertain, and for a number of reasons. Within the altered international economic climate, Mongolia faces the necessity of cultivating a new set of trade and investment ties and searching for areas where it can command a comparative advantage. However, it has yet to research, study, debate, or formulate any visions, strategies, or policies for the future development of its key industrial sectors. Mongolia must devote its attention to



a relatively new issue, environmental conservation, and to the promotion of tourism as a new industrial sector. On top of that, it must cultivate the institutions that will play a leadership role in developing its industrial sectors.

Given the current situation, the priorities of development policy should be placed on the following goals for now.

- (1) The rehabilitation of infrastructure for the supply of electricity, steam, coal, and other sources of energy essential to industrial growth and public welfare, and of railways, roads, and other networks for the shipment of industrial raw materials. The policy focus here should be shifted from emergency repairs over the next few years to medium-term programs for the recovery and expansion of supply capacity.
- (2) Full-scale rehabilitation of output capacity in the manufacturing, mining, and crop-farming sectors. In this respect, it will be important to evaluate carefully economic viability of restructured enterprises under the new economic circumstances.
- (3) A major restructuring of the corporate organizations and institutions that reinforce economic and social infrastructure and production capacity. In particular, it will be crucial to restructure existing state-owned enterprises and the banking sector, and establish the legal and policy foundations as well as support services for ventures in the livestock, agriculture, manufacturing, and service industries (e.g., the provision of credit to farms and small and medium-sized businesses, livestock veterinary services, the establishment of cooperative systems, etc.)
- (4) Enhancement of education, health care, and other social welfare services, and the establishment of poverty-alleviation programs and safety nets for the poor. Frameworks and systems in these fields should be streamlined and made more efficient and equally important fiscal resources to that end should be secured.
- (5) The most important task for macroeconomic policy will be in the area of fiscal restructuring: in particular, establishment of the tax system to boost fiscal revenues.

### **3. Orientation and Approaches for Japanese Assistance**

#### **3.1 Basic Viewpoints, Assistance Priorities and Considerations for Assistance Implementation**

Orientation and approaches for Japanese assistance to Mongolia are summarized in the table on the following page.

Japanese assistance must fundamentally be designed to help Mongolia achieve its economic and social development goals, strategies, and policies. Over the longer term, the focus will likely be on helping Mongolia achieve self-sustained economic growth. At present, however, smooth economic transition is the challenge Mongolia has given top priority. Accordingly, the emphasis of Japanese assistance for now should be on helping Mongolia in that transition. The transition process will demand that Mongolia pursue institution-building activities in the broad sense, and train the personnel who will be responsible for running and managing the new institutions and frameworks once that transition is complete. Consequently, it seems advisable that Japanese assistance be multifaceted and wide in its scope, that is, extending beyond financial and technical assistance, as such, and placing stress on intellectual assistance for efforts in institution-building and the formulation of development strategies and policies, as well as assistance for programs of personnel training.

## Basic Viewpoints on Assistance to Mongolia, Priorities and Considerations for Implementation

### A Shift in the Goals of Mongolian Economic Policy

Economic stabilization



Sustained economic stability

Structural reforms, economic revival and growth



### Constraints to Development

#### <Environmental and Geographic Factors>

- Regional gaps attributable to country's vast terrain; frigid temperatures and marginal rainfall
- High trade-related shipping costs attributable to Mongolia's status as a landlocked country

#### <Transition-related Factors>

- End to artificial economic supports (e.g. the COMECON framework, Soviet assistance and market access)
- Within new international market climate, Mongolia remains behind in terms of foreign trade, investment, and the development of competitive sectors.
- Long-term development outlooks, sectoral visions, development strategies, and policies largely unaddressed and/or nonexistent. Sectors that could lead the development process still lacking in capacity.
- Disarray caused by fast-track economic and administrative reforms



### Orientation and Approaches for Japanese Assistance

#### <Basic Viewpoints>

#### Support for transition to free-market economy

Expertise support in the arenas of institution-building and the formulation of development strategies and policies, coupled with more comprehensive and multifaceted forms of assistance, with an emphasis on aid for the cultivation of human resources to run and administer the country's new market-oriented systems.

#### <Long-Term Stance>



Support for strategies of self-reliant economic

#### <Priority Sectors for Assistance>

Priority Sectors	Development Status	Focus Area	Factors Demanding Attention
1. Full-scale rehabilitation of social and economic infrastructure	Emergency assistance has been provided to stem further declines in the country's production and supply capacity.	Heavy priority placed on sweeping enhancements in coal, steam, and electric power production capacity.	Many structures have reached an advanced stage of decay, and will be difficult to renovate because they were built with components or materials originating in the former Soviet Union. The economic viability of such rehabilitation projects should be closely compared with the cost of investments in entirely new structures.
		Heavy priority placed on measures to upgrade transportation, shipping, and communications infrastructure.	Though there is extensive social demand, new infrastructure projects in these sectors should be weighed with care.
2. Measures to improve social and welfare services and curb growth in the percentage of the population living below the poverty line	The transition process has created conditions of economic disarray, whereas structural adjustments have added to the share of the population living below the poverty line.	Participation in UNDP-led programs for social infrastructure development and poverty alleviation considered worthwhile.	New systems and programs should be formulated to assist the Mongolian government in securing more budget resources, improving its cost structures, and streamlining its frameworks for the supply of various public services.

3. Infrastructure projects for the mining industry and related sectors	The Mongolian economy is heavily dependent on the mining of coal and copper. Gold mining has helped buoy the country's economic growth in recent years.	Focus on assistance for the formulation of government initiatives at the initial stage of development: development surveys, technology transfers, and infrastructure projects at the development stage.	Coordinated international efforts in technical and financial assistance will be necessary if Mongolia is to overcome existing development bottlenecks in this field.
4. Infrastructure projects for the agriculture and livestock sector and the manufacturing sector	Mongolia has a limited supply of suitable grazing land for livestock-raising purposes. Prospects are therefore poor for expanding livestock production on the basis of traditional grazing practices. Also, the manufacturing sector is hampered by the diminutive domestic market for its products, and on top of that, it is geographically isolated from the international market.	Private-led projects recommended. As direct assistance to productive economic activities is difficult, the aid focus should be placed on various forms of expertise support and technical assistance, particularly for surveys and research, policy formulation, institution building, and the dissemination of useful technologies and knowledge. However, some direct forms of aid could conceivably be pursued as efforts in poverty alleviation.	No consensus has been reached on effective ways to help Mongolia shift from traditional nomadic to "semi-nomadic" forms of livestock farming. As to crop farming, it will be necessary to determine whether boosting output to pre-1990 levels makes economic sense, and whether the government should maintain its policies of self-sufficiency in wheat.

#### <Considerations for Assistance Implementation>

- Integrate elements of institution-building and human resources development into assistance programs and projects.
- Pursue strengthened ties and coordination with major aid institutions.
- Careful preliminary assessments and evaluations will be necessary regarding assistance for new investment projects.

In view of the development issues now confronting Mongolia, the sectoral priorities for Japanese assistance will conceivably be as follows.

- (1) Support for full-scale rehabilitation work in the energy sector, transportation and communications, and other areas of economic and social infrastructure. However, in the energy sector, it will be necessary to evaluate the economic viability of projects for rehabilitation as compared to new green-field projects. Additionally, in the transportation and communications fields, it will be essential to place emphasis on the importance of cross-border passenger and cargo flows. New transportation projects should be carefully evaluated from the viewpoint of economic and social demand.
- (2) Support for the provision of education and health care services, and the creation of social safety nets for the poor. Though securing fiscal appropriations will be vital, it will also be important to assist in streamlining and boosting the efficiency of the systems for the provision of social services. Also, it will be worthwhile to consider furnishing assistance to

the poor through the framework that has been set up for UNDP-led projects in poverty alleviation.

- (3) Support for the mining and related industrial sectors. Technical and financial participation by multinationals will be essential to development efforts in this particular field. Priorities should be placed on the formulation of development policy frameworks, development studies and other forms of technical cooperation, and financial assistance for infrastructure projects during the development stages.
- (4) Support for the livestock, crop-farming, and manufacturing sectors. It is advisable that development programs in these areas be privately led. Accordingly, Japanese official assistance should be focused in surveys and research, policy formulation, institution-building, technical cooperation, and intellectual support and personnel training programs for the dissemination of new technologies and expertise. Nonetheless, as steps in poverty alleviation, Japan should also consider providing technical and financial assistance to programs for the construction of storage facilities, water wells, and small-scale processing facilities for livestock and farm produce.

In implementing assistance to Mongolia, Japan should pay attention to the following three points. First, it is recommended that all Japanese assistance projects and programs include an institution-building or human resources development dimension, whether they are for technical cooperation, financial assistance, or intellectual support. Second, that Japanese assistance should be closely coordinated with the IMF, World Bank, ADB, UNDP, and other major assistance institutions. In this respect, Japan should actively cooperate with and contribute to the policy formulation efforts of these institutions: e.g., through the Mongolia Assistance Group Meetings or through co-financing. Third, concerning assistance for new investment projects, preliminary cost-benefit analysis and evaluation should be carefully implemented in consideration of rapid change in the market structures and economic systems of Mongolia.

### **3.2 Key Sectoral Priorities for Assistance**

The key sectoral priorities for assistance are listed below.

- (1) Intellectual support for the formulation of economic policies and institutions and administrative and fiscal reforms**

- (1) Formulation of economic and social development programs
- (2) Administrative and fiscal reforms and fiscal policies
- (3) Formulation of broadly defined industrial policies
- (4) Restructuring of state-owned enterprises, including those in the banking sector
- (5) Macroeconomic policy (joint projects with the IMF and World Bank)

## **(2) Agriculture and Livestock**

(Long-term assistance)

- (1) Formulation of national agricultural development plans
- (2) Research on ways to replace traditional nomadic livestock grazing practices with semi-nomadic approaches

(Medium-term assistance)

- (3) Support for the creation of farm and livestock cooperatives
- (4) Construction of small-scale livestock processing facilities
- (5) Construction of crop storage facilities
- (6) Support for enhancements in livestock production techniques (e.g. support for livestock research institutes)

(Short-term assistance)

- (7) Support for frameworks to supply improved seed strains (support for farms engaged in seed production)
- (8) Improved veterinary and animal hygiene services
- (9) Support for fodder production (e.g., for capacity expansion at feed-producing plants)
- (10) Repairs to mechanical water pumps in areas of open-range grazing

## **(3) Economic Infrastructure (transport and communications)**

(Rail sector)

- (1) Enhancements in rail transport capacity (through construction projects, improved repair facilities, technical cooperation, and personnel training)
- (2) Support for linkage to the Chinese rail network

(Road sector)

- (3) Development of trucking routes through China (assistance for the planning, design, and construction phases)
- (4) Technical cooperation and personnel training for the establishment of road infrastructure management, development, and repair frameworks

(Aviation sector)

- (5) Work to upgrade local airports (particularly for the promotion of the tourism industry)

**(Telecommunications sector)**

- (6) Financial assistance for rehabilitation and expansion of the Ulaanbaatar telecommunications network
- (7) Financial assistance for the modernization and expansion of local telecommunications networks
- (8) Technical cooperation for personnel training, institution-building, planning, and sectoral management

**(Postal service sector)**

- (9) Intellectual support and human resources development for the formulation of long-term postal sector development programs
- (10) Provision of postal transport and delivery vehicles

**(4) Mining and Manufacturing**

- (1) Technical cooperation for mineral-deposit exploration and feasibility studies
- (2) Technical cooperation aimed at incorporating environmental considerations into mining and manufacturing development programs
- (3) Intellectual support and technical cooperation for the modernization of production systems in the manufacturing sector.
- (4) Technical cooperation and small-scale loan-based assistance for the development of new consumer products and markets

**(5) Energy**

- (1) Development of energy infrastructure (e.g., rehabilitation of existing infrastructure, investments in modernization, development of new coal fields and sources of electric power, sweeping improvements in systems for the supply of steam heating)
- (2) Technical and financial assistance for the electrification of, and supply of steam heating to, rural districts (villages and towns)
- (3) Personnel training and intellectual support for sectoral management
- (4) Intellectual support and technical cooperation for the formulation of sectoral development strategies (e.g., arrangement of investment projects, feasibility studies for small-scale water-power generation, strategies for diversified sourcing of petroleum products)

**(6) Human Resources Development**

- (1) Intellectual support for rebuilding the education system (including the formulation and implementation of comprehensive human resource development programs and

sector-based systematic training plans).

2. Support for the creation of mobile classrooms and distance education systems for the children of herding families.
3. Support for the construction and operation of elementary and secondary school dormitories for the children of herding families.
4. Support for the development of new teaching materials.
5. Dispatch of teaching staff for higher education.
6. Support for teacher retraining.
7. Support for the establishment of adult-education programs designed to improve skills and expertise (including the fields of finance and accounting).
8. Support for herdsman education (for innovations in livestock technology).
9. Support for the training of managers, administrators and engineers (training programs of various kinds, including those in Japan).

**(7) Social Infrastructure (health care, employment, and poverty-alleviation programs)**

**(Health care)**

- (1) Provision of health care equipment, materials, medicine, and means of transportation and communications
- (2) Health care staff and medically related technical cooperation
- (3) Support for the training of health care personnel (e.g., instructional materials, equipment and facilities, training programs)

**(Employment and poverty alleviation)**

- (4) Support for poverty-alleviation projects (e.g., for small public works projects, small-scale entrepreneurial ventures, and the activities of NGOs, including women's groups)



## **I. The Development Outlook**

### **1. Political and Economic Conditions in Mongolia**

#### **1.1 Current Political and Economic Conditions and Policy Issues**

##### **(1) Land and Resources**

Mongolia is distinguished by a set of political, economic, and social circumstances unknown to most other developing countries. It has an unusually low population density, with 2.3 million citizens spread over a territorial land area of 1.6 million square kilometers (about four times the land area of Japan, or half the size of India). In addition, extreme local environmental conditions pose exceptional hardships for human subsistence as well as for most industrial activities. For one, Mongolia is in a frigid zone; the average monthly temperature nationwide ranges below the freezing point from November to March. As rainfall is limited, about three-fourths of the entire country is in natural grassland, and most of the rest, in desert zones. Arable districts suited for crop farming are located in the north, and amount to no more than 1% of the country's entire land area. Though part of Mongolia is mountainous, it is geographically limited in its exploitable water and forest resources, due to a low average of precipitation nationwide. Also, while it possesses relatively rich deposits of copper, gold, molybdenum, and other minerals, it is hampered by a poor domestic transport infrastructure as well as the fact that it must haul such minerals over more than 1000 kilometers through China or Russia simply for access to ports for export. From an economic standpoint, the costs and difficulties of transport alone make the extraction of such mineral resources an exceptionally formidable undertaking. These natural conditions are effectively mirrored in Mongolia's history as a largely nomadic culture where many of the activities of life and subsistence revolve around natural and extremely extensive livestock grazing. Furthermore, such natural conditions help explain serious gaps in development potential and character that have emerged in certain parts of the country.

##### **(2) Politics and Foreign Relations**

Mongolia in modern times has been heavily influenced by China and Russia, the two countries between which it is geographically sandwiched. It achieved its independence only a few years after the Russian Revolution, adopted a socialist economic system modeled on the Soviet Union, and for nearly seven decades sought to impose its designs for a socialist state in practically every political, economic, and social dimension of life. In fact, policies of socialization were applied to grazing—one of the most difficult activities to collectivize. Even

the livestock raised by the nomadic population were placed under state ownership. As Asian members of COMECON (CMEA), Mongolia and Vietnam saw their economies integrated into Soviet/East European frameworks for the international division of labor.

In the late 1980s, when it was evident that the Soviets and East Europeans had reached the brink of economic collapse, Mongolia's government decided to embark on a program of reforms aimed at breaking the country out of its own economic deadlock. However, Mongolia did not initiate any major moves toward political democratization or free-market economic liberalization until the early 1990s, after the Soviet Union had crumbled and the COMECON framework had been dismantled. Nonetheless, the historical pattern of its economic transition coincided with that of the Soviet Union and its East European allies, and its strategies and policies for the process closely resembled the "shock therapy" approach these countries employed.

Since 1990, Mongolia has been engaged in a process of institutional reform and policy transition that began with revisions to its constitution and that included legislative steps aimed at creating a parliamentary democracy and a market economy. The first stage of this process was put into effect by the coalition that won control of the government in the first round of general elections. That coalition was headed up by the Marxist Mongolian People's Revolutionary Party, the former communist party which eventually became a parliamentary democratic party. In 1992 the MPRP won a majority in parliamentary elections and with that reinforced mandate, pushed ahead with the transition process.

The second round of general elections, held in the summer of 1996, resulted in a landslide victory for the Democratic Union Coalition, which was led by the opposition, the Mongolian National Democratic Party and the Mongolian Social Democratic Party. Upon assuming power, the coalition government immediately instituted sweeping structural reforms in the government apparatus as well as a major reshuffle in important policy-making posts. Though it will be some time before the new government's policy orientation comes into clear focus, for the most part expectations are that it will pursue additional steps toward democratizing the state apparatus and fostering headway in the formation of a market economy together with the continued privatization of most economic activities.

Mongolia's policies on foreign relations have also shifted considerably in conjunction with the above-outlined structural transition. Some years prior to its breakup, the Soviet Union began withdrawing forces it had stationed in Mongolia, effectively bringing an end to a

long-standing bilateral military alliance. From an international security standpoint, Mongolia has since pursued a policy aimed to balance its diplomatic ties with Russia, China, and Western powers, including the U.S. From a Northeast Asian security standpoint, Japan and the U.S. have welcomed this shift in foreign policy, especially in view of Mongolia's geopolitical significance as a vast territorial buffer between Russia and China. Needless to say, Mongolia needs export markets as well as sources for imports of essential goods if it is to make progress in developing its economy. That is why close economic ties with Russia and China are so vital. However, given the current economic realities in these countries, it would appear that Mongolia for now has little recourse other than to seek economic assistance for its efforts in structural transition, from international organizations and from Japan and other leading industrial powers. In fact, Mongolia for some time to come will likely remain dependent on such sources if it is to obtain essential capital, technologies, and development assistance for future undertakings in its economic development.

### **(3) Current Economic Conditions**

Despite poor initial conditions and a set of formidable natural constraints, Mongolia posted a measurable degree of headway in its economic development during its 70-year span of socialism. Though traditionally focused in nomadic activities, the economy during this period witnessed the debut of a manufacturing sector fed by livestock products, a mining industry oriented toward the extraction of copper and other minerals for export, and crop-based agricultural ventures run by large-scale collectives and state farms in line with policies for food self-sufficiency. Urbanization proceeded in the meantime, resulting in 60% of the entire population being urban-based by early 1990. On top of that, the country achieved substantially advanced levels of primary education, health care, and other facets of social welfare despite the difficulties posed by its vast geographical expansiveness and the traditions of its largely nomadic culture. By 1990, national literacy reached 96%, and 90% of the population had access to public health care services.

In 1991, the Soviet Union broke up, and the COMECON framework was in turn taken apart. These developments inflicted three major blows on the Mongolian economy.

The first came on the trade front. With the unraveling of COMECON, Mongolia lost most of its Soviet and East European markets for exports of its industrial goods. Not only that, but subsequent chaos in the Russian economy left Mongolia with no major external sources of the intermediate goods or capital goods it needed to supply its manufacturing base or urban distribution sector. For Mongolia, these events translated into a loss of external markets and

an end to the benefits it had enjoyed until then on the basis of a set of institutionally favorable terms of trade.

The second blow came in the arena of economic aid. During the socialist era, Mongolia received virtually automatic annual extensions of economic assistance on a scale comparable to 30% of Mongolian GNP from the Soviet Union, in the form of grants and ruble loans. Though this aid dwindled sharply during the latter 1980s, it disappeared for good once the Soviet Union collapsed. Mongolia thus lost a vital source of economic support for its international balance of payments and fiscal budget.

The third blow perhaps should be described as a drain of human resources. By some estimates, as many as 100,000 Russian nationals resided in Mongolia prior to the Soviet breakup. While most were military personnel or their dependents stationed at military bases inside Mongolia, a significant fraction were technicians and managerial professionals involved in the affairs of planning, building, or running certain sectors of the Mongolian economy. For instance, between 5,000 and 6,000 Russian supervisors and engineering personnel were assigned to the Erdenet copper mining operation that had been set up as a Soviet-Mongolian joint-venture. In addition, there were around 180 Russian supervisors and engineering personnel on the 1,200-employee work force at the Central Energy System's Ulaanbaatar Power Station No. 4, Mongolia's largest generating facility. Though some ongoing joint-ventures count as exceptions to the rule, the vast majority of Russian personnel returned home when the Soviet Union fell apart. This seriously undermined the management and operation of Mongolian projects in the mining and infrastructure fields.

To be sure, the government's fast-track policies for structural transition also have had an impact. In effect, price deregulation, currency devaluation, financing of fiscal deficits through monetary expansion, and other factors together stoked an explosive upswing in inflation. For instance, the GDP deflator reached 400% at one point in 1993. These compound influences in turn triggered a cumulative downtrend in GDP, which in 1994 bottomed out at a level 20% below its 1990 peak. As a proportion of GDP, the contraction in Mongolian economic activity did not seem that large compared to trends in other COMECON countries. After all, a 20% drop in GDP was far less serious than the 40% plunge registered in Russia, and more or less on a par with the downswings experienced in Poland, Hungary, or Rumania. On the other hand, a closer look at the components of the setback itself effectively highlight just how serious the impact on the Mongolian economy has been. For one, due to sharp cutbacks in imports of intermediate goods, machinery, parts, and other capital goods for maintenance and repair purposes, coal and electric power output fell to crisis lows. In

addition, the nation's output of copper, not to mention that of wheat and other farm products, dwindled for essentially the same reasons. On top of that, exports of livestock and of industrial goods derived from livestock by-products dropped not only as a result of shortages of imported oil and machinery parts, but also in response to the loss of export markets in the Soviet Union and across Eastern Europe. Furthermore, the construction sector was dealt a devastating blow by sharp rollbacks in investment that had been largely funded through Soviet budgetary support.

In the end, elements of economic and social service infrastructure in the urban sector were heavily impacted. Unemployment and poverty spread in parallel with a trend of hyperinflation, adding to the burden of hardship faced by the average citizen. Nonetheless, thanks to its strongly self-sufficient nomadic cultural tradition, Mongolian society was buffered to some extent from the full, adverse impact of the country's sudden economic decline. The shock of economic transition itself prompted a reversal in the population's until-then sustained urbanization trend, as city-dwellers packed up and returned to the nomadic life in search of stable work. According to statistics for the five-year span from 1990 to 1995, employment shrank by 100,000 workers in the manufacturing sector but grew by a corresponding 90,000 in the livestock and crop farming sectors. Still, worsening fiscal straits brought on by the economic transition have had a negative impact on life, even for members of Mongolian society who have followed a largely self-sufficient nomadic tradition, in the form of cutbacks in government outlays for education, health care, and other public services. According to the Mongolian government and the World Bank, economic deterioration boosted the number of poor people, including unemployed workers, households with a female head and nomads in possession of few livestock. As a result, by the middle of 1994 this group accounted for more than a quarter of the entire population.

In the meantime, various laws were amended and new laws established in an effort to lay the groundwork for the country's transition. The first stage of that undertaking registered a certain measure of success. The legal framework for a parliamentary democracy was put into place, beginning with the introduction of a new constitution. Parliamentary elections (for seats in the State Great Khural) were held on two occasions, with the reins of government shifting smoothly from the ruling to opposition parties. The government actively engaged itself in the task of readying the legal system for the transition to a market economy. In addition, it adopted a voucher formula for privatization of state-owned companies modeled on the East European approach, and completed the first stage of the privatization process on that basis. In 1995, the private sector accounted for fully 60% of the country's entire industrial

output; on top of that, more than 40% of all public sector assets were transferred to the private sector. By 1992, privatization had spread to nearly 100% of all ventures in the livestock and agricultural sectors, 40% in manufacturing, 60% in the commercial and external trade sectors, and 35% in services. The power and water utilities, heating fuel suppliers, railways, communications services, and other essential infrastructure-centered public enterprises were excluded from the privatization process, along with operations in coal and copper mining by the Erdenet joint-venture with Russia. In the financial sector, two banks out of four were privatized.

The three earlier-described blows to the Mongolian economy, along with the slowdown and various other strains stemming from the transition phase, prompted the government to pursue a number of strategies to stabilize the economy. In return, by 1994 the economy had largely steadied and had begun to show signs that it was headed into a renewed upswing. As one outcome of negotiations with the International Monetary Fund (IMF) and other international organizations, Mongolia adopted an austerity package of sharp budget cuts and also shifted to a tight monetary policy. In the meantime, Japan, the World Bank, the ADB, the U.S., Germany, the IMF, and other members of the Mongolian Assistance Group decided to supply a huge package of emergency aid and other forms of funding in the interest of helping the country ease its balance of payments position and budget difficulties, supporting its measures in economic stabilization, and financing emergency repairs in those areas of energy infrastructure essential to daily life. All told, these steps enabled Mongolia to tame runaway inflation that at one point had climbed as high as 400%.

Though real GDP had been on a downtrend since 1991, it grew 2.3% in 1994, and then accelerated to 6.4% the following year. This turnaround is largely attributable to contributions from the export-oriented textile industry, the commercial and other service industries, and to gold output, which demonstrated renewed growth following the transition to a market economy. The recovery itself, however, has yet to reach into all industrial sectors, except for the livestock sector.

#### **(4) The Outlook for Economic and Social Development**

The stabilization measures prompted by the transition process have shown some measure of effectiveness. Accordingly, stabilization has now all but lost its importance as the primary policy objective. Structural reforms along with economic recovery and expansion will be the chief hurdles for Mongolia over the next few years. However, several factors suggest a firm recovery and fast expansion will remain out of reach for some time to come.

First, as a member of the Soviet Union and the COMECON economic bloc up to 1991, Mongolia enjoyed several economic advantages in terms of trade and aid. Largely for that reason, it achieved comparatively intensive levels of economic activity and advanced standards of living and social welfare that otherwise would not have been possible with its own natural resources, natural conditions, and human resources alone. Now that those artificial advantages have been swept away, the country has found that restoring its economy to 1990 levels will not be an easy task. In fact, by some predictions, that goal will likely demand substantial policy commitments and several more years of hard work.

Second, within the altered international economic environment, Mongolia faces the task of establishing a new set of foreign trade and investment ties and searching out new fields where it is capable of commanding a comparative advantage. Some of the investments and development undertakings it pursued along the industrialization path laid out by the COMECON framework for intraregional specialization have proven economically pointless in terms of current international price structures. However, in view of its formidable natural climate, and especially its severe transport-related disadvantages as a vast inland country with no seaports of its own, Mongolia will not find it that easy to cultivate new, growth-led sectors endowed with comparative advantages in the international marketplace. What is more, though Russia stands out as potentially the most important market for Mongolian exports, Russia is itself caught up in its own economic transition, a process that has been accompanied by serious economic weakness and turmoil. Another problem in this area is that economic ties with China have been cool at best since the two countries broke off relations in the 1950s. These factors have hampered Mongolia's quest to capitalize on its rich reserves of mineral resources.

At this point, the long-term outlook for Mongolia's economic development remains somewhat obscure. That is primarily because the country has yet to pursue the studies and policy debates essential to the formation of visions or development strategies for the advancement of the economy as a whole and of its productive sectors within the newly emergent economic climate. To be sure, livestock, manufacturing, mining, and commerce and other service industries all count as industries with sufficient levels of latent growth potential. The picturesque Mongolian landscape has already been used as a tourist resource, and much potential exists. Translating that potential into actual growth and prosperity, however, will demand that the Mongolian government craft supportive industrial policies and cultivate a market economy climate that allows for the effective function of the corporate sector, which, after all, should play a leading role in the industrial development process. Needless to say,

these are not tasks that can be accomplished in a short period of time.

Given this state of affairs, it would appear that Mongolia should pursue the following development priorities for the time being, that is, up to the year 2000.

First, priority should be placed on a full-scale drive to restore and repair vital elements of economic and social infrastructure. In the course of its economic transition, Mongolia witnessed an infrastructural deterioration of crisis proportions in its mass-transit and transport systems, as well as in its systems for the supply of coal, electric power, thermal power, and other energy forms to industrial and household consumers. To forestall further deterioration, priority has been placed on investments in emergency repair and renovation work for several years now. However, it is considered essential that the country continue with this drive in infrastructural renovation for several more years. Infrastructural supply pipelines for energy and material goods are essential not only for economic activity, but—in a country with a natural climate as harsh as Mongolia's—also for life itself, especially in the urban districts.

A second priority will be focused in restoring the productive capacity of the manufacturing, mining, and crop-producing agricultural sectors. Some industries in these sectors have lost their economic viability within the new economic milieu, and as such, it would basically be pointless to invest seriously in their restoration now. Yet, except for some that were never economically viable in the first place, there are others that have seen their output tumble or languish simply because they lacked raw materials or other intermediate inputs, or faced shortages of imported parts or other capital goods.

Third will be sweeping efforts to restructure the corporate organizations and institutions that have a supporting role to play in terms of economic or social infrastructure and productive capacity. The initial, voucher-based formula for the privatization of many state enterprises has essentially run its course. The next phase will involve a more difficult approach: liquidation of state enterprises in the capital markets. In this second phase, it will be necessary to either restructure the remaining public sector enterprises so they can operate profitably within the new economic environment, or, barring that, liquidate them outright. Efforts in restructuring will involve the difficult task of introducing new accounting standards, mandating sound financial management practices, and writing off chains of inter-business bad debt. Restructuring drives will be especially crucial in the banking sector, which has been left holding a massive burden of bad debt on loans made to state enterprises that essentially have no economic future.



Aside from the issue of restructuring the remaining state enterprises, the task of cultivating new ventures in livestock, manufacturing, crop farming, the service industries, and other productive sectors is a process that should be left to the initiative of the private sector. The government should for its part concentrate its priorities on the task of laying the necessary legal and policy frameworks and providing various support services (e.g., credit for farmers and herders, as well as small businesses, veterinary services, programs aimed at fostering the use of new technologies, and so forth).

A fourth priority area has to do with the budgetary deterioration that accompanied the transition process. To ease its fiscal strains, Mongolia to date has followed a strategy that places emphasis primarily on reducing fiscal expenditures. That strategy was adopted for a number of reasons: for one, because it was considered too difficult in the short term for the country to effectively boost its revenues through an enhanced tax collection effort, and for another, because emphasis had been placed on macroeconomic stabilization.

However, one by-product of this approach was that the government had to cut spending on education, health care, and other social services. Furthermore, the privatization of the *negdel* (agricultural and livestock farming cooperatives) meant that consumers themselves had to begin footing the bill for the social and welfare-oriented public services these collective production units formerly furnished for free. In the meantime, the ranks of the unemployed and poverty-stricken climbed in tandem with headway in the transition process. Increases in the number of children who do not attend school, together with a general decline in educational quality, also count among the legacies of the government's austerity policy. Accordingly, for the next several years, it seems imperative that priority be shifted to the creation of social safety nets for the poor, and to programs in poverty alleviation, education, health care, and other areas that will have a significant influence on life for citizens now and far into the future. It will also be necessary for the government to place stress on the formulation of essential policies for these programs, as well as on measures aimed at securing the budgetary resources needed to put them into effect. In the process, though, it will also face the necessity of streamlining and in other ways boosting the operational efficiency of its frameworks and systems for the provision of social services in general.

A fifth priority—in this case one relevant to macroeconomic policy—should probably be placed on fiscal restructuring, in line with the framework for macroeconomic management formulated through discussions between Mongolia, the IMF and the World Bank. As noted

earlier, economic stabilization has essentially been the primary objective of fiscal policy up to now, and to that end, budgetary cuts have been the chief *modus operandi* for the accomplishment of that objective. However, this approach has cut public services and the functions of government to the bone. Consequently, in the years ahead, policy priorities must be shifted toward measures aimed at boosting fiscal revenues as well as rationalizing budgetary expenditures to improve efficiency.

## 1.2 Mongolia's Economy and Development Plans

### (1) External Shock: the Soviet Collapse

From 1980 to 1990, real GDP growth in Mongolia averaged a respectable 6.2% per annum. With the start of the 1990s, however, the country entered a difficult new phase prompted by an external blow: the collapse of the Soviet Union.<sup>1</sup>

In structural terms, the Mongolian economy was heavily dependent on the former Soviet Union up to the end of the 1980s. As a country integrated into the old COMECON framework for the international division of labor, Mongolia did about 85% of all its foreign trade with the Soviet Union alone, exporting copper and other mineral resources along with wool and leather products in return for imports of machinery, machine parts, and energy resources (the country depended entirely on the Soviet Union for oil imports). On top of this, injections of Soviet aid amounted to more than 40% of Mongolia's net material product. In fact, practically all major engineered structures and other key components of infrastructure now operational in Mongolia were completed with the help of Soviet or East European aid. Even the new industrial center of Darkhan is widely recognized as an achievement backed by Soviet-led aid. Given this relationship of dependence, the Mongolian economy was effectively shaken to its very foundations once the Soviet Union finally crumbled.<sup>2</sup>

From 1991 through 1993, real GDP traced a net decline averaging around 9.0% year on year. In fact, per-capita GDP also continued to shrink in the process. However, in 1994, the former reversed course and began rising again: to 2.3% that year and on up to 6.3% in 1995. Per-capita GDP followed suit, charting growth of 1.0% in 1994 and then 4.5% the ensuing year.

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<sup>1</sup> Unless otherwise indicated, the 1991, 1995, and 1996 editions of *Mongolian Economy and Society* (published by the State Statistical Office of Mongolia) are the sources for the statistical data here and below. Also, in this paper, these sources are referred to generically as "statistics yearbooks."

<sup>2</sup> See Bayar, S. (1995).

These figures suggest that the Mongolian economy has more or less absorbed the impact of the Soviet collapse and is now leveling off. However, as will be explained later on, this emerging phase of calm is on extremely precarious ground, and Mongolia still faces the task of placing its economy firmly on a fresh growth course.

## **(2) Internal Shock: the Transition to a Market Economy**

In addition to the external factors behind the new stage of difficulty it faced with the start of the 1990s, Mongolia was also hit by certain developments at home. In 1990, the country became a parliamentary democracy and embarked on its transition from a planned to a market economy (including the privatization of state-owned enterprises). Needless to say, this structural transition thrust Mongolia into a phase of economic upheaval.<sup>3</sup>

Around 1989 and 1990, state assets in Mongolia had an appraised value totaling about 50 billion tögrög (Tg). The government decided to privatize about 44% of that total (Tg22.0 billion), and to that end, adopted the "voucher-system" introduced by East European countries issuing all citizens one voucher, each with a face value of Tg10,000.

Each of these Tg10,000 vouchers incorporated a pink coupon worth Tg3,000 and a blue coupon worth Tg7,000. The former was for purchases of capital assets held by small businesses, and could be exchanged for cash. The latter was for purchases of assets in large commercial enterprises by private citizens. A securities exchange was set up for the trading in blue coupons, and functioned as a primary market in that respect, thus facilitating the transfer of corporate ownership into private hands. The initial stage of privatization involved a process that saw pink coupons issued first, followed by the issue of blue coupons.

As a result of these measures, by 1995 about 90% of the country's 28.57 million head of livestock were back in private hands, along with almost all enterprises in the commercial sector (5,144 companies, including 484 that were formerly state-owned, plus another 200 or so under government control). Mongolia now has a secondary market securities up and running, and has moved into the second stage of privatization in a bid to heighten the ratio of public sector privatization.

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<sup>3</sup> For additional discussion on economies in transition, see Kuribayashi, Sumio (1996).

### **(3) Structural Changes in the Demand Side**

Mongolian statistics express GDP demand structure purely in terms of consumption, total capital formation, and net exports, with columns for statistical discrepancy. In 1995, the statistical discrepancy measured -15.8% relative to GDP, a scale that largely undermines the analytical usefulness of such data. Ignoring that drawback for the moment, here we shall examine the figures for trends in consumption, investment, and net exports.

#### **1) Consumption**

Though it dipped sharply during the period from 1990 to 1992, consumption turned around and posted a year-on-year gain of 6.7% in 1995.

#### **2) Investment**

Investment also fell sharply during the 1990 to 1992 period, and continued to languish thereafter. In 1995, it registered a setback of 14.7% on the year before.

#### **3) Net Exports**

In 1991, the ratio of net exports to GDP stood at -22.9%. From that point, the negative margin began to shrink, and in 1995 was replaced by a ratio of 6.9% in the positive range. It is instructive to view this in terms of trends in total trade volume. Reflecting the turbulent changes at home and abroad, in 1991 total exports fell by half their level on the year before, and continued to languish for some time. In 1995, however, such factors as the rising price of copper, a principal export, coupled with expanded exports of gold, helped Mongolia post a renewed export recovery, on the order of \$511.6 million. Though imports contracted by an even larger margin than exports, in 1995 the total was up somewhat, weighing in at \$388.7 million. Through sustained government efforts to rein in imports and achieve a healthier balance of payments position, Mongolia closed 1995 with a trade surplus of \$122.9 million.

In 1990, the Mongolian economy was dependent on exports for 33.7% of total demand, and on imports for 47.1% of total supply: both rather high percentages (as ratios relative to GDP, here and below). What is more, by 1995 these levels had actually risen: to 64.1% and 48.7%, respectively. In other words, the Mongolian economy has assumed a strongly trade-dependent nature.

#### **4) Demand-side Issues**

From the above analysis, it would appear that consumption and exports are the key

sectors of macroeconomic demand now driving the steadying course in the economy. In effect, Mongolia faces the task of adding new momentum—that is, by boosting investment and lifting the capital utilization rate—if it intends to guide its economy into a renewed phase of strong growth.<sup>1</sup>

#### (4) Structural Changes in the Supply Side

##### 1) Changes in Industrial Structure

##### (1) Industry and Agriculture (Livestock and Crop Farming)

In 1990, the industrial sector accounted for 35.6% of the country's GDP. Since then, though, that share has followed a downtrend that placed it at 28.8% in 1995. What is more, in 1995, industrial GDP grew by only half a percentage point in real terms from a year earlier. Among the sector's principal products, in volume terms, copper concentrate was up 0.9%, electric power slipped back 3.3%, processed meat demonstrated no change, and cashmere products registered a steep gain of 81.3%.

By comparison, the agricultural sector saw its share of GDP climb from 15.2% in 1990 to 36.7% in 1995. Indeed, its GDP contribution widened 6.0% year on year in 1995 alone, a pace substantially stronger than that registered by the industrial sector. As volume figures for the principal product categories reveal, in share terms wheat output in 1995 was essentially unchanged on its 1990 level of 43.0%, whereas that for the five key livestock categories combined was up 10.5% from its 1990 level, effectively highlighting a pattern of decline in the crop farming subsector and a heightened level of activity in the livestock subsector. However, as will be discussed in a later chapter, the livestock sector as a whole has been hit by a complicated array of formidable problems ranging from a downtrend in fodder output to the difficulties herders have had in liquidating raw materials surpluses stemming from business slowdowns in the urban leather-goods and knitting industries.

<sup>1</sup> According to Kuribayashi, *ibid*, note 3, the macroeconomic production function for Mongolia is calculated as follows, where Y is GDP; A is a constant value; L is labor; K is capital stock;  $\alpha$  and  $\beta$  are expressions of elasticity relative to elements of Y; T is the time trend; and  $\gamma$  is the time trend coefficient. Figures in parentheses are t values.

$$\ln Y = 3.161 + 0.376 \ln L + 0.582 \ln K - 0.011T \quad R^2 = 0.990, \quad DW = 2011$$

$$(6.990) \quad (3.268) \quad (9.901) \quad (-9.5350) \quad \alpha + \beta = 0.958$$

For example, to sustain a GDP growth rate of 5.0%, it follows that the value for capital stock, K, must increase by a factor of 8.0% for every 1.0% increase in labor, L.

## 2) Construction, Transport, Communications, and Trade and Material Technical Provision

All of these sectors account for a declining share of GDP. In 1995, their shares were as follows: construction, 2.2%; transport, 3.5%; communications, 1.1%; and trade and material technical provision, 13.5%.

## 3) Services and Other Sectors

Fluctuating trends have clouded the share of GDP attributable to services and "other sectors." In 1995, they accounted for 11.8% and 2.3%, respectively.

## 2) Changes in Employment Structure

Changes in employment structure closely parallel the patterns of change that have been detected in industrial structure. For instance, comparing figures for 1990 and 1995, the industrial sector's share of total employment slipped from 16.8% to 13.6%, whereas the corresponding share attributable to agriculture went up from 33.0% to 44.6%. Also, though the construction, transport, and communications sectors all registered declines, trade and material technical provision, services and "other sectors" more or less held their ground.<sup>5</sup>

## 3) Supply-Side Issues

On the supply side, though gains have been achieved in the livestock sector, other sectors have experienced setbacks. One uptrend in supply has been set by relatively informal segments of the tertiary industrial sector (such as "vendors" who buy goods in China, South Korea and other countries.) The livestock sector has sustained its growth by assimilating surplus labor, and in so doing, it is to be credited for averting shortages in the food supply. While the unemployment rate accordingly fell from 7.5% in 1994 to 4.5% in 1995, around 80,000 people were still out of work, a relatively large number that will not be that easy to accommodate. Another point to consider is that agriculture's expanding share of supply and industry's diminishing share are at odds with the usual pattern of development, something that suggests additional steps to spur growth are needed in the non-livestock sectors. Incidentally, labor productivity in the industrial sector is around 2.57 times higher than it is in the agricultural sector.

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<sup>5</sup> Assuming labor growth in a particular sector is identical to the average for the entire labor force, it should be possible to obtain a general picture of the labor flows among different sectors by focusing on actual deviations from the average. By the writer's own estimates, between 1990 and 1995, 25,400 workers left the industrial sector, 37,400 left construction, 26,900 left transport and communications, and 11,500 left other sectors, for a total of 101,300. In the meantime, the agricultural sector assimilated 91,800 workers, and the trade and material technical provision sector, another 9,100.

## **(5) Changes in Trade Structure**

Export product structure strongly reflects industrial structure. Therefore, from a development strategy perspective, it is always imperative to have an accurate understanding of export structure when examining a country's heavy dependence on trade.

### **1) Changes in Trading Partners**

#### **(1) Exports**

In 1990, 78.3% of all Mongolian exports were destined for the former Soviet Union; Czechoslovakia and Bulgaria accounted for only a few percent. By 1995, though, the situation had changed significantly. In descending order, Japan that year accounted for 18.7% of Mongolian exports, followed by Kazakhstan at 15.2%, China at 14.3%, Switzerland at 13.2%, and Russia at 13.1%. Although there is a statistical discomformity problem caused by the collapse of the Soviet Union, this nonetheless indicates that Russia's share was down dramatically.

#### **(2) Imports**

The former Soviet Union accounted for 77.1% of all imports flowing into Mongolia in 1990. By comparison, East Germany, Czechoslovakia, and China each contributed only a few percent. In 1995, Russia held top share at 52.0%, followed by Japan at 11.4% and China at 10.1%. Though Russia's share has fallen somewhat, it still measures over half the total, effectively highlighting a continued Mongolian structure of dependence on Russian imports.

#### **(3) Trade Value**

In value terms, the former Soviet Union accounted for an overwhelming 77.8% share of the total in trade with Mongolia in 1990. In 1995, Russia was top-ranked at 29.9%, followed by Japan at 15.6%, China at 12.5%, and Kazakhstan at 8.7%.

### **2) Changes in Composition of Trade**

#### **1) Exports**

Mongolian exports can be roughly classified into the following: copper and molybdenum concentrate, fluorspar, coal, cement, and other primary mineral products; wool, cashmere, and products thereof; and assorted leather goods, meat, and livestock.

One noteworthy point is that 1995 volume indices for most of these products registered negative growth year on year. For instance, while copper concentrate accounted for

38% of total export value in 1991, Mongolia exported 435,000 tons in 1995, which amounted to a year-on-year decline of 3%.<sup>6</sup>

In other words, as Mongolian government officials also have pointed out, the 1995 gain in export value was itself largely one outcome of a spiral in international prices for certain merchandise exports. Trends in the price of copper are instructive in this respect. Though the price (in cents) of a pound of copper on the London Metal Exchange went down from 87.9 to 72.0 between 1991 and 1993, thereafter it reversed course and headed up, reaching a level of 110.2 by 1995.<sup>7</sup>

## **(2) Imports**

The key merchandise imports for Mongolia include transport vehicles, household appliances, petroleum, chemical fertilizer, building materials, paper, grains, and vegetable produce. In 1995, the country registered year-on-year increases in practically all these categories. In volume terms (with 1990 as the base year = 100), imports of buses reached a level of 132.9; cars, 1,428.3; silk, 815.8; and refrigerators, 220.0. Most other import categories, however, had yet even to recover to their 1990 levels.

## **(6) Inflation, Fiscal and Monetary Policy, and the Exchange Rate**

Between 1990 and 1993, Mongolia experienced spiraling inflation on the order of a 100% to 260% increase in the GDP deflator year on year. This was one macroeconomic feature of the transition process, brought on in part by the collapse of the Soviet Union and a consequent shrinkage in the scale of trade, which expressed itself on the supply side in the form of shortages of oil and other energy resources, as well as machinery parts.<sup>8</sup> Since then, the country has been largely successful in bringing inflation back under control; in 1995, the GDP deflator measured a much lower 29.9%.

Accepting the IMF conditionalities, the Mongolian government during this period followed a set of policies aimed at reining in inflation through cuts in fiscal outlays. As a ratio of GDP, fiscal expenditures measured 17.2% in 1991 and 26.1% the following year. After leveling off, in 1995 they amounted to 37.8% of GDP. For comparison, the fiscal deficit (as a

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<sup>6</sup> World Bank (1996b), p.363.

<sup>7</sup> IMF (1996), p. 81.

<sup>8</sup> Petroleum imports consist of diesel fuel, gasoline, fuel oil, and oil-based lubricants. In 1995, these imports totaled 312,900 metric tons, a figure equivalent to only 39.6% of the amount Mongolia imported in 1990 (789,800 tons).



ratio of GDP, with revenues including grants) measured 4.2% in 1995, down from 12.9% in 1991.

On the other hand, virtually no significant changes were witnessed in the structure of fiscal revenue. Though the share of the corporate tax in total government revenue held steady at 37%, the government collected almost no tax revenue on individual incomes. The expenditure front, however, witnessed a relatively sweeping structural shakeup. In particular, the 6.1% share of expenditure that went to the manufacturing, construction, and mining sectors in 1991 had dwindled to 0.0% by 1995. In addition, the corresponding share allocated to the transportation and communications sectors slipped from 4.6% to 2.4%.

Though these changes in one respect clearly derive from cutbacks in outlays to former state-owned enterprises, it should be remembered that the program of fiscal austerity also created a variety of distortions: economic as well as social. For instance, though education accounted for 22.9% of total expenditures in 1990, its share weighed in at 15.8% in 1995. This deterioration in the educational environment was further aggravated by teachers' strikes stemming from wage discontent. Additionally, cuts in central government subsidies have drastically undermined the scale of spending at the local government level (from 18.8% to 12.5% in terms of GDP). Largely for this reason, conditions of poverty still persist in rural communities, another fact that underlines the urgency of fiscal reform.

Marshallian  $k$ , or the ratio of M2 to GDP, is one useful yardstick of monetary trends. Though this ratio stood at 53% in 1990, by 1995 it had fallen to a level of 26%. Inflation is, of course, closely tied to increases in the money supply. As one step in macroeconomic stabilization, Mongolia sought to hold the money supply constant, a policy that seems to have been highly effective in taming inflation. Despite the success in curbing inflation, though, these policies also created some problems in the financial sector, which saw ultrahigh interest rates (around 30% in real terms if the GDP deflator is used). This, in conjunction with the earlier-cited cuts in budgetary subsidies, dealt a serious blow to the management of former state enterprises already saddled with debt burdens inherited from their pre-privatization days. Debt relief for these businesses has thus emerged as yet another pressing challenge.

Assistance from industrial nations and international financial institutions will be discussed in a later chapter, along with the topic of private-sector loans. In 1994, Mongolia's long-term debt measured 48.7% of its GDP. For comparison, IMF credit measured 4.5%, and

short-term debt, 1.8%.<sup>9</sup> Mongolia's debt to Russia from the socialist era amounts to 10.6 billion transferable rubles, and Russia has demanded its repayment at a ruble-dollar exchange rate of one-to-one. Viewed from the nature of the assistance which gave rise to the accumulated debt, questions remain as to what exchange rate should be used in the calculation, as do doubts about Mongolia's ability to repay the debt. Nevertheless, it is not conceivable that even Russia could solve this problem swiftly, and both countries have agreed to defer the issue for the time being.

The collapse of the Soviet Union severely undermined the foundations for transferable rubles. This in turn forced Mongolia to devalue its own currency, the tögrög, which until that point had been linked to the ruble. Trading at around Tg5.3 to the U.S. dollar in 1990, the tögrög, thereafter continued to soften, and was eventually allowed to float in 1993. By 1995, it traded at Tg190 to the dollar. Yet even at this exchange rate, the tögrög was actually considered overvalued, for real inflation at the time was running close to 30% in Mongolia. However, as a result of September 1996 hikes in fees for electricity and other public utility services, the currency was trading around Tg720 to the dollar as of November 1996.

#### **(7) Development Strategy Priorities**

##### **1) Long-term National Development Plans**

Under the administration that stepped down in June 1996, the former National Development Board had been leading efforts to put together a long-term national economic development program. That program comprised three developmental stages, as outlined below.<sup>10</sup>

- (1) A transitional stage from 1996 to 2000, involving steps towards macroeconomic stability and averting an economic crisis, placing priority on infrastructure projects (GDP growth target of 4%).
- (2) A preparatory stage from 2000 to 2010, to position the country for its economic take-off. Steps to update industrial technologies given top priority (GDP growth target of 6%).
- (3) An economic boom stage, from 2010 to 2020, during which the goal will be to achieve a more advanced economic and industrial structure and establish the foundations for self-

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<sup>9</sup> Ibid. note 6.

<sup>10</sup> National Development Board, Government of Mongolia (1996).

sustained economic growth (GDP growth target of 8% to 10%).

The following sectors were expected to serve as engines of growth during the first stage: agriculture and livestock, infrastructure projects (especially for improved rail access to mining sites), export industries (including the manufacturing sector), and tourism. Furthermore, the wealth accumulated by these sectors was to be mobilized for the development of other industrial sectors. Mining, livestock processing, and biotechnology were among the fields cited as candidates for the cultivation of new industries.

Mongolia has pastoral assets considered capable of sustaining a ceiling of around 30 million head of livestock. Plans thus called for holding pastoral development within this level and striving for efficiency gains in utilization per head of livestock. In view of the country's ceiling potential yield of around 500,000 tons of wheat, the government also felt that self-sufficiency constituted yet another serious challenge. The basic position here was that instead of expanding cultivable acreage, the country would be better off fostering the use of irrigation tools and techniques as a means of boosting yields. On the issue of infrastructure development, planners took the position that steps to lure more foreign investment, harness the build-operate-transfer approach, and establish free trade zones should be promoted, given the outlook for relatively insignificant growth in domestic savings through the foreseeable future.

## 2) Economic Policies of the New Administration

As the foregoing illustrates, the previous administration had put together a development strategy centered on the notion of developing Mongolia's resource industries with foreign investment. Under the new, opposition-led administration that has since taken office, the outlook for this long-term program is now up in the air. As of this writing, the new administration had yet to unveil any distinctive long-term development strategy of its own. However, in August 1996 it did announce a nine-point agenda for reform as follows, thus effectively providing a rough profile of its economic policy orientation.<sup>11</sup>

### (1) Emergency Budget Cutbacks and Hikes in the Cost of Living

In view of the outlook for revenue shortfalls deeper than initially forecast, the new government decided to enact sweeping budget cuts in a number of areas, including social security, public services, and pension funds. As it happens, electricity-, heating-, and oil-price

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<sup>11</sup> UNDP (1996).

freezes imposed by the previous administration over a two-year span spurred deteriorating financial conditions and business difficulties in these sectors. To compensate, the new government decided to introduce a set of steep fee hikes (increases from 30% to 60% were put into effect Sept. 1, 1996).

**(2) Reforms in the Banking and Financial Sectors**

The deteriorating health of Mongolia's banking sector is expected to reach crisis proportions. Accordingly, the Bank of Mongolia (central bank) has been given a stronger hand in the management of the country's commercial banks.

**(3) Fiscal Reform**

Smaller government and a reduction in the tax rate (to 30%) were two of the election pledges made by the incoming administration. To fulfill those pledges, it plans to pursue fiscal reforms and move ahead with revisions to the civil law.

**(4) Poverty Alleviation**

The new government also has plans to find the causes of poverty, study the current conditions, and then formulate and implement new projects in poverty alleviation.

**(5) Privatization**

A new privatization schedule has been announced. Practically all enterprises in the manufacturing sector are to be privatized, and 60% of national assets transferred to the private sector. In addition, the privatization of public residential properties will be started in urban districts in 1996, and carried out on a national scale in 1997.

**(6) Deregulation**

Regulations in effect on the meat, flour, wheat-production, and oil-refining sectors will be relaxed. To spur heightened competition, oil price controls and oil import subsidies will be abolished.

**(7) Infrastructure**

Mongolia will continue to seek economic cooperation from donor countries for projects aimed at bringing an end to power brownouts and shortages in its major cities. Mongolia had sought to join the WTO and seal arrangements for the promotion of trade with China and Russia (Mongolia later joined the WTO). To boost foreign trade, ongoing efforts will be made to strengthen the country's transportation infrastructure and further cut shipping costs.

Additionally, the country will strive to cultivate new export products and diversify its exports in general.

#### **(8) The Fight Against Corruption**

The administration will put together a code of ethics for civil servants, and set up internationally accepted audit frameworks for key state-owned enterprises.

#### **(9) Utilization of Foreign Assistance**

While showing appreciation for the benefits of foreign assistance, the government will nonetheless devote attention to past mistakes and problems and strive to harness such assistance in a more effective fashion. To that end, it is to establish a new organization involved with assistance affairs, directly responsible to the prime minister.

The new government also has other plans in addition to the agenda for action outlined above. For instance, rather than pursuing programs that put emphasis chiefly on the Ulaanbaatar area, it intends to follow a regional development policy that splits the country into four development districts. Also, it is currently studying whether to allow foreign companies to own real estate under the Foreign Investment Law. In addition, fresh moves have been made to have the Ministry of Finance, and the Ministry of Agriculture and Industry assume leading roles in the country's economic management. Of course, there is ample reason to believe that in exploring its long-term strategy options, the new administration may have adopted some of the development policy perspectives and concepts of its immediate predecessor.

### **1.3 Politics and Foreign Relations**

#### **(1) Politics and Government**

##### **1) An Overview**

In the years following 1990, Mongolia embarked on a drastic policy course aimed at transforming its over-seven-decades-old socialist system into a parliamentary democracy with a market economy. In the process, it also sought to put an end to its deep-seated structural dependence on the former Soviet Union. Clearly, its leaders are to be credited for basing this transformation on the democratic processes of lawmaking and the ballot box, and without spilling a single drop of blood or arresting any political dissidents.

The political reform process in Mongolia began in the late 1980s as a venture in economic restructuring prompted in part by the Soviet Union's own *perestroika* drive. Gradually, though, it assumed an increasingly politicized dimension. Starting out as a small pro-democracy group of 300 or so activists in late 1989, it quickly flowered into a full-scale democratization movement. From that point forward, the tempo of democratization, the economic transition, and the move away from Soviet influence all gathered momentum. Five short months later, in May 1990, the country formulated a revised constitution that put an end to the era of one-party dictatorship by the Mongolian People's Revolutionary Party (MPRP). The first major step toward the creation of a market economy came in January 1991 with price deregulation. Next, in May that year, the country set about the task of privatizing its state-owned enterprises on the basis of the new National Assets Privatization Law. The following February of 1992 saw socialism officially abandoned and the promulgation of a new constitution that even went as far as changing the country's name. Finally, general elections held at the end of June 1996 seated a new government led by a democratic coalition (which won 50 of the 76 seats), thus putting an end to over seven decades of rule by the MPRP and effectively ushering Mongolia into a new era.

While these developments essentially transformed Mongolia into a political democracy, rapid changes in 1990 and thereafter brought Mongolian society at large face-to-face with an array of serious new problems. Indeed, the scale of economic and societal upheaval has been immense. Though the structural transition compelled the government to pursue fast-track measures aimed at putting new systems into place, so far its actions have not been sufficiently effective.

Once in power, the new coalition moved forward quickly to enact a range of sweeping administrative reforms, dismantle regulatory barriers, cut the budget deficit, promote privatization, and put a stop to corruption. These efforts had the effect of accelerating the democratic process and the transition to a market economy. On the downside, hard economic times are expected to confront the transition with various obstacles, a prospect suggesting it will be quite a while before Mongolia is able to demonstrate real results.

## 2) Elections and Headway in the Democratization Process

Political reforms in Mongolia have entered a new stage set by three successive legislative elections and one presidential election since the start of the 1990s.

The country adopted a multiparty system in 1990. In the first democratic elections held in July that year, the opposition parties were unable to manage more than a minority.

The MPRP on the other hand had effectively taken the lead in the reform process, and accordingly won a landslide victory with 83% of the vote. The MPRP sought a coalition with a third party in a bid to end political animosities and foster the democratization process together with far-reaching measures toward overhauling the economy. To be sure, the MPRP continued to dominate politics for some time even after Mongolia had become a parliamentary democracy. In the first general elections (June 1992) held under the new constitution, it won by a landslide, taking 70 of the 76 electoral seats. On the other hand, the first presidential elections in June 1993 were won by the opposition leader Ochirbat, creating a situation of disharmony between the presidency and legislative branch of government. In general, though, stability has continued during the political process.

However, in the second round of general elections held on June 30, 1996, the MPRP was roundly defeated by the Democratic Union, a coalition headed up by the Mongolian National Democratic Party and the Mongolian Social Democratic Party. The main reason the MPRP lost was because voters were fed up with the pattern of distortion, foot-dragging, and indulgence that had come to symbolize its long-term reign--and not so much because they were attracted to any opposition electoral platform, *per se*.

The MPRP structure of one-party rule lasted for fully seven decades. Eventually, that bred a climate of political cronyism that trickled down to the lowest echelons of the bureaucratic machine, reaching into all corners of society and deteriorating into essentially nothing more than a system of political influence and graft. This in turn nurtured a culture driven by abuses of power, the illegal misappropriation of national assets, and an unabashed appetite for bribery. As such, the MPRP grip on power effectively impeded efforts to stimulate the economy. The democratic camp cleanly severed its ties with this entrenched political structure and brightened hopes for the creation of a new political system firmly planted on democratic principles.

### 3) Legislative Preparations for a New Political Framework

Mongolia moved forward with work on the legal framework for its full-scale structural transition--politically, economically, and socially--starting in January 1990 with market-economy-oriented directives and following up in May that year with the adoption of a multiparty system and a revised constitution that introduced a presidential system of administration. Efforts in this area were accelerated with the establishment of its new constitution in February 1992. Given that the country was effectively striving to overhaul its entire structure, the difficulties seem easy to imagine. In his final report before the State

Great Khural in July 1996, Chairman Bagabandi noted that the legislative body had passed 369 laws (including amendments) and 374 parliamentary resolutions in the four short years under the Jasrai administration that took power following the debut of the new constitution in 1992.

However, while Mongolia has made headway with its legal reforms at least on paper, it faces an array of problems that raise doubts as to whether they have been fully effective in practice. What is more, in numerous cases it has been known to amend new pieces of legislation repeatedly and within only a short time after they are enacted. Another problem is that with the scarcity of print media and the poor circulation of information, the public often has little, if any knowledge of newly enacted legislation.

Nonetheless, suffice it to say the government did at least succeed in laying the legal groundwork demanded by the structural transition process, and has since carried that lawmaking drive into the second stage. Eventually, it will face the task of pursuing consistency in rules and laws, as well as additional amendments in tandem with the progress toward a market economy. For now, debate will likely center on the issue of revising ownership provisions of the land law, laws concerning the privatization of public housing, new additions to the commercial code, and revisions to laws on investment. However, with the debut of the Democratic Union coalition government, attention can be expected to focus increasingly on revisions to the tax code and amendments to the laws on social security. As it happens, a new law for the privatization of public housing was quickly passed in October during the autumn session of Parliament, and is slated to take effect on January 1, 1997.

#### 4) Administrative Issues

The Mongolian government has been noted for administrative inefficiency and irrationalities. In fact, the central and local governments' administrative apparatus at the rural level is not even fully operative. There are various reasons for this state of affairs. However, it seems to stem largely from an inability to shake off the abuses of the entrenched socialist command-and-control framework. Such abuses survived with the overwhelming powers of influence the MPRP continued to hold over Parliament, administration, and the corporate sector under the de facto climate of one-party rule that persisted for some time even after the country had become a democracy. Those abuses have manifested themselves, for example, in the deep-rooted political cronyism that pervades all levels of central and local government; strongly insular jurisdictional rivalries that undermine effective cooperation between separate administrative divisions; inadequacies in the decentralization of power;



and ambiguities on the issue of accountability. Another noteworthy factor behind the government's administrative ineffectiveness is the organizational weakening that has resulted from repeated rationalization and downsizing measures and a drain of skilled public servants to companies in the private sector. At any rate, it would appear that the administrative sector is presently incapable of satisfying the increasingly varied needs of the business sector, or of the general public, as the country moves forward along the path of economic transition. This lack of capability has also extended to the absorption and utilization of foreign assistance.

On the other hand, the administrative structure has been frequently changed on a large scale. For instance, in April 1990, Mongolia dismantled eight ministries, including those responsible for light industry, foreign trade and supply, and added five new ones, including a construction ministry and ministry of heavy industry. All told, it effectively downsized its administrative apparatus from 16 to 12 ministries, but in July 1992 created five new agencies (including the Ministry of Construction and Town Planning, the Ministry of Administration, and the Ministry of Nature and the Environment), raising the total to 17. A continuous series of reforms has at times accompanied this process, however. Though the Ministry of Energy, Mining, and Geology was dismantled in 1990, in February 1991 it was broken up into separate mining and geology agencies. These were soon consolidated into a new Ministry of Geology and Minerals in July 1992, and that in turn was transformed into the Ministry of Energy, Geology, and Mining in January 1994.

However, almost immediately upon assuming office in July 1996, the new Democratic Union coalition embarked on a bold course of administrative reform that slashed the ministry apparatus from 13 to nine, in the process consolidating or dismantling the ministries of Industry and Trade, Culture, Population Policy and Labor, as well as the above-mentioned Ministry of Energy, Geology, and Mining. Though the Ministry of Trade and Industry had been instrumental in charting the country's economic policy course, it was dismembered and integrated into the ministries for Finance, Foreign Affairs, and Agriculture and Industry. The government also dissolved the National Development Board, which had until then been the chief administrative pipeline for the arrangement of foreign aid.

For all its work, however, it seems clear that the government has not followed any consistent set of administrative-reform guidelines. In some respects, to be sure, it would appear that only a superficial attempt has been made to fulfill the demands of operative reinforcement or restructuring. Albeit a proponent of accelerated steps toward

democratization, the latest administration has undertaken a series of major administrative reforms that saw no debate in Parliament, let alone by the general public, and that were implemented without adequate preparation. This approach has inevitably created many doubts, including whether the new government's actions will help sustain administrative responsibilities, services, and continuity, bring desired gains in administrative efficiency, or add momentum to the democratization process. Another point worth noting is that the government has significantly reshuffled executive administrative posts, a move that seems destined to have an unsettling influence for some time to come.

The lack of discipline in the civil service is sobering. Scandals involving the abuse of power, bribery, and other forms of corruption receive frequent media coverage, and have drawn harsh public criticism. High government officials are from time to time implicated in suspicious dealings, to the extent that investigative commissions have been set up by Parliament. In November 1995, the director of the state prosecutor's office released a report disclosing the extent of illegal conduct by responsible public servants at the local government level, thus revealing how serious corruption had become at the *aimag* and *sum* levels.<sup>12</sup> In response, in November 1995 Parliament began deliberating an anti-corruption bill and in June 1995 the administration itself enacted a set of disciplinary restrictions on public servant misconduct. Yet so far, such actions appear to have had little if any success. Though the new government has accorded it top priority, solutions will not be easily forthcoming for the simple reason that this issue happens to be so closely tied to the character, expertise, and job security of public servants themselves.

#### 5) Social Upheaval

Societal problems—as embodied in educational disarray, widening gaps between the rich and poor, and a rising crime rate—count among the most formidable of challenges confronting Mongolia at this time. As a country with no developmental precedent of capitalism, democracy or bourgeois democracy, it should certainly come as no surprise if Mongolia finds itself face-to-face with society-wide upheaval as a result of its abrupt transition from a centrally planned command economy to one based on an entirely different set of principles. And in point of fact, the drive to build a market economy has indeed been accompanied by social disorder due to economic disruptions and changes in values. Examples include an increase in the number of school-age children who refuse to attend school, and a sharp

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<sup>12</sup> Administratively, Mongolia is divided into 21 *aimag* (provinces) and the capital Ulaanbaatar (special city). Each *aimag* is further subdivided into around 20 *sum* (rural districts), each *sum* being composed of the smallest administrative units, the *hög* (sub-district).

uptrend in the incidence of crime. Worse, these trends have since evolved into urgent political issues.

In 1995, Mongolia was hit by a nationwide school teachers' strike that lasted for close to four months. Teachers in compulsory school grades were essentially demanding better remuneration along with improvements in the educational environment. As it happens, the squeeze on education-related budgetary expenditures had thrown the school environment into disarray; in addition, their livelihood threatened, many teachers opted for other professions. As the student dropout rate soared, teachers became increasingly disaffected.

The government, for its part, has been trying to do something. In particular, in February 1995 it put together a new 10-year core program for compulsory education and in June that year designated 1996 as the "Education Year". On the issue of student absenteeism, it presented local municipalities, schools, and parents a set of explicit guidelines and responsibilities, and in October enacted an ordinance on school supervision that incorporated stringent punitive provisions with fines for violators. In 1995, student absenteeism averaged close to 12% nationwide. Some schools in rural communities, however, reported that up to 60% of their students had dropped out.

Efforts to regain a semblance of social order have been pursued on a national scale. In view of the harmful impact the climbing crime rate posed for business activity and life in general, the government in June 1995 set up a special task force under the President and assigned it the mission of drafting a new crime prevention law. In July 1995, the State Great Khural unveiled a new law-and-order program; moreover, November that year saw the administration institute new law-and-order regulations. Though these actions apparently had the effect of slowing the explosion in crime somewhat from the 30% to 40% surges experienced in 1992 and 1993, in 1995 the incidence of crime still gained a strong 10.7% on its level the year before. By some statistics, over 60% of all offenders were jobless or intoxicated at the time of their wrongdoing, thus adding substance to the view that unemployment or truancy mixed with alcohol leads to crime. This equation in turn, however, highlights the pivotal economic side to social disorder in Mongolia.

#### 6) Japanese Assistance in the Administrative Dimension

Mongolia needs assistance to sustain the core administrative services and functions performed by its government apparatus to deal with the above-outlined problems. Japan to date has provided various forms of technical cooperation, including programs inviting

Mongolian management-class personnel, dispatching Japanese experts to Mongolia and receiving Mongolian trainees. It would seem effective to continue these efforts, and in parallel, offer additional trainees' acceptance programs aimed at finding suitable administrative structures, fostering effective employee placements, establishing operational tie-ups between different government institutions, improving administrative services, and defining civil-servant responsibilities. Such undertakings would be even more effective provided they have the cooperation of local governments in accepting Mongolian officials from the national down to the *aimag* level. From both an immediate and long-term perspective, benefits could be expected to increase if these programs were focused specifically on the middle-management-class employees who run the actual day-to-day business affairs of their department.

Though Mongolia has apparently moved into the second phase of work toward preparing its legal framework for economic transition, the accomplishments to date remain meager in certain respects. Making additional headway seems urgent, and assistance to that end will probably be essential.

## **(2) Foreign Relations**

### **1) An Overview**

Following the Sino-Soviet rift in the 1960s, Mongolia adopted a strongly pro-Soviet foreign policy and assumed virtually no diplomatic initiatives of its own making. After its transformation into a democracy, Mongolia sought to establish a more-balanced relationship that placed it on equal terms with Russia. In 1991, the State Great Khural introduced a set of foreign policy guidelines that, among other things, steered the country onto a new diplomatic course aimed at securing its own independence and sovereignty. The primary objective was to balance its relations with Russia and China. Secondly, Mongolia was interested in promoting its ties with Japan, the U.S., Germany, and other leading industrial countries, and in fostering closer ties with countries of the Asia-Pacific region. Accordingly, it has been actively pursuing a multilateral diplomatic offensive. While economic development is of course one of the goals Mongolia has in mind with this strategy, gaining prestige for itself in the international community is yet another. On top of that, by pursuing a diversified foreign policy, the country hopes above all else to work out reassuring security arrangements, especially now that it is no longer under a protective Soviet umbrella.

As a landlocked country with a small population and no seaport access of its own,

Mongolia has no choice but to accommodate the political and economic clout of its two neighbors, China and Russia. As has long been the case in the past, Mongolia's relations with both will continue to have a key impact on its own future. Decisions regarding ties with both is thus of foremost priority in diplomatic policy. Yet from that standpoint, the newly elected government has few fresh foreign policy options to choose from, a reality that suggests it will be forced essentially to follow in the footsteps of its predecessor. That prospect notwithstanding, it appears that the new Democratic Union coalition is interested in strengthening the country's ties with the West-Japan and the U.S. in particular.

## 2) Ties with Russia

Dependence and domination were the two fundamental features long characterizing bilateral ties between Mongolia and the Soviet Union. In 1987, though, this pattern was altered dramatically as the Soviets began withdrawing forces they had stationed on Mongolian soil. With that move, infusions of Soviet aid to Mongolia decreased, but in return, so did Soviet dominance. The decisive departure from the Soviet camp came in 1990, when Mongolia decided to pursue its own future under a banner of national self-determination. Though this enforced the Mongolian sense of national pride, it also dealt a bitter blow to the economy. Trade ties shriveled up, as did supplies of Russian oil. In addition, economic chaos stemming from the breakup of the Soviet Union and the COMECON trade framework also had a heavy impact.

Though ties with Russia were all but nonexistent at one point, in 1992 Mongolia began taking serious steps toward their restoration. While this had an economic dimension, it also appears to have been prompted by an interest in slowing the expansion in Chinese influence that had begun to fill the vacuum left open by a weakened Russia. In March 1992, Prime Minister Byambasuren visited Moscow in a gesture aimed at improving bilateral ties with Russia. That action resulted in the creation of a new economic cooperation council, together with fresh Russian pledges of economic assistance to Mongolia. In January 1993, President Ochirbat paid a visit to Russia and concluded a bilateral friendship and cooperation pact. This pact strengthened the impression that the two countries had established ties on equal terms. For one, it required that Russia respect the Mongolian policy of refusing to allow foreign troops to pass through or be stationed on Mongolian territory. For another, it stipulated that neither party should participate in any military or political alliance that would be hostile to the interests of the other.

In effect, Mongolia's new diplomacy of nonalignment can be termed a success.

Bilateral ties with Russia have begun to pick up. For instance, customs procedures have been streamlined, arrangements have been formulated to complete various projects that were suspended when Soviet aid dried up; debt payments to Russia have been rescheduled; and the two countries have agreed on a barter deal which saw 40,000 tons of Mongolian copper exchanged for 300,000 tons of Russian oil.

Though trade with Russia has been on a general downtrend, the country still accounts for the largest share of Mongolian imports: 52% of the total in 1995. Russia is only the fifth-largest market for Mongolian exports, absorbing 13%. However, its share ranks highest at 28% when the former Soviet republic of Kazakhstan is included. The level of civilian interchange is also up: in 1994 alone, more than 270,000 Mongolians visited Russia.

### 3) Ties with China

Ties with China began improving quickly in 1991, as if to fill in the power vacuum left by the Soviet Union. The expanded influx of Chinese-made consumer goods and private Chinese investment into Mongolia were especially impressive. Though the two countries had only one customs house on their common border some years ago, in 1992 they opened ten more. Bilateral trade boomed, and Chinese-backed private sector investment in Mongolia increased dramatically. In August 1991, Chinese President Yang Shangkun visited Mongolia and signed an accord granting the landlocked country overland access to Chinese seaports for trading purposes. In building its ties with Mongolia, China demonstrated enthusiasm in various other ways: e.g., by offering a 50 million yuan loan for the construction of small-scale factories, and granting a five-year deferral on repayments on loans it provided Mongolia in the 1950s and 1960s.

In 1990, China accounted for only 2% of Mongolian exports and imports. The following year, however, saw its share of exports and imports surge to 15% and 4.5% respectively. By 1993, China absorbed 31% of all Mongolian exports, and supplied 17% of its imports. This uptrend fell back somewhat in 1994, with figures coming in at 19.9% and 9.2% respectively. On the investment front, Chinese investments in Mongolia seem relatively small-scale on a project-by-project basis. In terms of number of projects, though, China now ties with Russia for first place. One joint-venture with China is a new trade center in Ulaanbaatar, which opened its doors in July 1995. Additionally, the following November saw the two countries set up a new customs facility in the Chinese border city of Manzhouli and Dornod aimag in Eastern Mongolia. Also, in an apparent bid to counterbalance a similar pact Mongolia had entered with Russia in 1993, Chinese Premier Li Peng visited Mongolia in April 1991 and sealed a friendship and cooperation treaty.

However, the trend toward deeper ties has aroused in many Mongolians a sense of alarm that is almost traditional as far as China is concerned. The initial influx of Chinese products came when Mongolia was facing a scarcity of basic goods. Since merchants at the time had little financial power, many of the imported products were of poor quality. This seriously tarnished the image conveyed by the term, "Chinese-made," and around 1994 the Mongolian mass media began presenting articles aimed at drawing attention to the defects in various Chinese products. That coverage, coupled with the spread of rumors, had such a negative impact on the popularity of Chinese merchandise that boycotts were even considered, if not actually carried out. In fact, this is one of the reasons trade with China dipped in 1994.

For Mongolia, though, security arrangements will be an essential precondition for solid ties with China; heightened levels of trade alone will not be enough. That reality suggests the new administration in Mongolia will be striving to step up exchange with China, particularly at the administrative level.

#### 4) Ties with Japan, the U.S., and Multilateral Institutions

##### (1) Japan

Relations between Japan and Mongolia remained rather cool for some time even after the two had established diplomatic ties. The only developments worth mention at the outset included a Japanese pledge of ¥5 billion in grant assistance for the construction of a cashmere plant, and, at the cultural level, a continuing program of exchange for teachers and students. Government interaction was limited to the vice-minister level, and trade was minimal. A major shakeup in that bilateral relationship began to emerge in 1987. That year saw Mongolia embark on a Western diplomatic offensive that included sending Foreign Minister Dugersuren, to Tokyo and establishing diplomatic relations with the U.S.

The visit by Foreign Minister Dugersuren fueled popular interest in Japan. Mongolia's mass media supplanted the traditional, derogatory rhetoric with articles colored by a more promotional tone--such as "Learn from Japan". Mongolia in a number of ways also began demonstrating a more active interest in boosting its ties with Japan. For instance, it decided to have People's Congress Chairman Linchin attend the funeral ceremony for Japanese Emperor Showa in February 1989, without waiting to see Moscow's decision. In response to that gesture of friendship, Japan sent Foreign Minister Uno to Mongolia the following May--actually the first visit by a Japanese foreign minister in the 17 years since the two countries had established formal diplomatic ties. That visit resulted in substantive

arrangements for a Japanese economic mission to the country, and the extension of technical cooperation, among other things. February 1990 occasioned the first visit to Japan by Prime Minister Sodnom. Furthermore, in November that year, President Ochirbat himself attended the imperial enthronement ceremony as Mongolian head of state. In an earlier era, the Soviet Union would have been the first stop on a Mongolian president's foreign itinerary. But President Ochirbat noted that he himself picked Japan for his first state visit after assuming office, effectively underlining the point that a visit to Japan meant much more to Mongolia than the formalities. The visits by Sodnom and Ochirbat brought the official bilateral exchanges up to the prime ministerial level. In August 1991, Japanese Prime Minister Kaifu visited Mongolia, thus setting the stage for expanded undertakings in the arena of economic cooperation.

Prior to that visit, Kaifu at the London Summit called for a concerted international drive to provide Mongolia with much-needed assistance. In addition, during his visit to Mongolia, Kaifu announced a number of Japanese assistance initiatives, including plans to hold a conference of Mongolian assistance-donor nations, known as the Mongolia Assistance Group. From that point, Japanese efforts grew more substantive; assistance earmarked for Mongolia began ballooning in 1991, and before long Japan had become Mongolia's single largest assistance donor in bilateral terms. Co-chaired by Japan and the World Bank, the Mongolian Assistance Group Meeting was convened five times by February 1996, beginning with its inaugural gathering in September 1991. Japan has consistently contributed almost one-third of the assistance provided through that forum, and has assumed an active role in helping coordinate international frameworks for assistance. In view of that record, Mongolian expectations toward Japan have continued to grow.

On another level of exchange, several developments highlight a trend toward closer ties of friendship and empathy between the Mongolian and Japanese people. In December 1994 Mongolia issued a new postage stamp commemorating friendship ties with Japan. In April 1995, it began broadcasting NHK television programs throughout the country. First aired in April 1996, the Japanese period drama series "O-shin" was a major hit with the public.

## 2) The U.S.

Relations between Mongolia and the U.S. have strengthened steadily since the two countries established diplomatic ties in 1987. The democracy movement in Mongolia began gathering momentum in 1990. U.S. Secretary of State James Baker visited Mongolia in May



that year. The following September saw the two countries reach an agreement on the promotion of foreign investment. In addition, at the private-sector level, U.S. investors have funded projects for camel-wool and yak-wool processing facilities and ventures in oil exploration.

Relations grew even closer in 1991. In January that year, President Ochirbat visited the U.S. and returned home with most-favored-nation status for his country. In March, the U.S. House of Representatives and Senate passed a resolution on economic assistance for Mongolia, and in July Secretary Baker made his second visit. The U.S. then began moving forward with specific measures, including emergency aid, technical assistance, and Peace Corps projects. In August 1995, the U.S. even pledged to provide Mongolia with defense technologies and equipment parts. Most U.S. assistance for Mongolia is grant-based. Investment from the private sector is focused primarily in oil-field development.

Leading Mongolian pro-democracy activists were invited to the U.S. when the movement was still in its infancy. In that way, the U.S. established itself as a supporter of the democratization drive. Now that the Democratic Union coalition has assumed power, it is anticipated that ties between Mongolia and the U.S. will grow even stronger.

### (3) Ties with Multilateral Institutions

Mongolia's need for assistance with its drive toward democratization and economic reform have been mentioned in a number of major forums: in the political declaration and chairperson's statement at the Houston Summit in July 1990; in the chairperson's statement at the London Summit in July 1991; and in the economic declaration at the Tokyo Summit in July 1993. Echoing this broad international consensus, the World Bank, IMF, ADB, UNDP, OECD, and other organizations have actively engaged themselves in a number of assistance programs for Mongolia.

Each of these organizations has a valuable role to play. The IMF and World Bank, for instance, have been helping Mongolia with its structural adjustment programs. Based on an agreement with the IMF, the Mongolian government has formulated and begun steps to implement provisions of its 1993-1996 Policy Framework for Macroeconomic and Structural Adjustment. The IMF and other organizations have agreed to continue assisting Mongolia in this area through 1997 and beyond.

The ADB has been providing Mongolia with financing and other forms of assistance

for projects in a broad range of fields, including electricity, communications, transport, livestock farming, the development of an insurance system, pollution abatement, and job creation. The UNDP is helping the country enhance its infrastructural base for investment, train management personnel, manage educational programs, devise programs of national accounting, and strengthen government policy makers' capacity.

#### **5) Japanese Assistance in the Foreign Relations Arena**

Diversified forms of assistance from donor nations and multilateral institutions will be essential to Mongolia. Japan should continue to serve as co-chair of the Mongolia Assistance Group Meetings and in that role, coordinate assistance from each donor nation and multilateral institution.

### **1.4 Trends in Assistance to Mongolia**

#### **(1) Overall Trends in Assistance to Mongolia**

##### **1) Trends in Type of Assistance**

According to statistics compiled by the DAC, assistance to Mongolia from 1990 through 1994 totaled \$516 million (contract basis).

In 1990 all assistance came in the form of grant aid<sup>11</sup>, but from 1991 onwards roughly 60% came in the form of grant aid while the other 40% in loan assistance.

Assistance aimed at helping the country improve its balance of payments situation (B/P support) accounted for 80% of all assistance in 1991, but fell to below 16% in 1993.<sup>12</sup> Project assistance, meanwhile, accounted for just 7% of the total in 1991, but grew to 93% in 1993. This reflects a structural change from a policy of "B/P support first, project assistance second" to one of "project assistance first, B/P support second." Complete details are provided in Figure 1-4-1.

##### **2) Assistance by Donor**

A breakdown of assistance to Mongolia by amounts (contract basis) and by country/organization reveals that of the cumulative total from 1990 through 1994, Japan was

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<sup>11</sup> Here we use the term "grant aid" in the broad sense, including that form known as technical cooperation in Japan.

<sup>12</sup> World Bank (1996a), p.3.

the largest donor (accounting for approximately 30%), followed in order by the ADB, Germany, the World Bank, the IMF, the UNDP, and the U.S. (see Figure 1-4-2). These seven donors provided nearly 90% of the total (87.5% of the cumulative total from 1990 through 1994), and financial assistance from other donors was limited.

### 3) Assistance Required in 1996 and Beyond

According to the Mongolian Government's "Project and Technical Assistance Proposals 1996-1998" which it distributed at the Fifth Mongolia Assistance Group Meeting in 1996, the country requires the following amounts of assistance over the three-year span from 1996 to 1998.

Type	Number	Amount (\$1 million)
Project assistance	39	617.6
Technical cooperation	46	40.6
Poverty alleviation programs	7	12.2
Total		670.4

Breakdowns of these projects by sector and monetary value are given in Figures 1-4-3 and 1-4-4.

Also at the Fifth Mongolia Assistance Group Meeting, the World Bank estimated the amount of medium-term assistance, required for the following five-year period, to be as follows.<sup>15</sup>

Type	Amount (\$1 million)
Public investment programs 1995-1998 (rehabilitation of existing facilities)	650
Large-scale investment projects	100-500
Balance of payments support (chiefly for reforms to the corporate and banking sectors)	150-200
Debt servicing	100-150
Total	1000-1500

The two plans cover different time periods—three years and five years—but they are nearly identical in terms of the amounts of assistance needed annually. Between \$180 million and \$270 million is required each year to provide the needed assistance laid out in the

<sup>15</sup> Ibid., 5.

five-year plan, and the World Bank believes that this can be covered with \$200 million in foreign assistance and \$50 million from Mongolia's development budget.<sup>16</sup>

#### 4) Mongolia's System for Accepting Assistance--Donor Coordination

Coordination of assistance from donors, primarily the seven major donors mentioned earlier, encompasses coordination on the receiving side, Mongolia, and coordination on the giving side, among the individual donors. The National Development Board (NDB) was responsible for coordination on the Mongolian side until July 1996, but following a major reshuffle of government agencies after the general election held on 30 June 1996, the responsibilities of the NDB were divided between the Ministry of External Relations and the Ministry of Finance. In addition, an assistance coordination committee under the direct control of the Prime Minister was established. These bodies are currently working together to coordinate the acceptance of assistance. On the donor side, five meetings of the Mongolia Assistance Group, co-chaired by the World Bank and Japan, have been held up to 1996.

Mongolia Assistance Group Meetings have been held almost annually since 1991, five times in all as of July 1996.<sup>17</sup> Japan has co-chaired the meetings with the World Bank since the second meeting. The number of participating countries and organizations has grown every year (see Table 1-4).

This is the only forum at which donors of assistance to Mongolia all gather in one place. At such meetings the participants discuss the current state of the Mongolian economy; medium- and long-term development priorities; and, the nature and directions of assistance required in the future. Through the meetings, participants are able to obtain valuable information to help them evaluate past assistance programs, ascertain other donors' future intentions, avoid duplication, and establish more effective complementary relationships.

The participants at meetings of the Mongolia Assistance Group do not necessarily make commitments to provide specific amounts of assistance during the respective year. One of the primary functions of these meetings, however, is to formulate a balanced and coordinated unofficial action plan for providing the total amount of assistance needed by Mongolia, as estimated by the World Bank, one of the two co-chairs of the meetings.

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<sup>16</sup> Ibid., 5.

<sup>17</sup> The first through third and fifth meetings were held at the Ministry of Foreign Affairs; the fourth meeting was held at JICA's Institute for International Cooperation.

The meetings' agendas reflect economic conditions in Mongolia and economic challenges confronting the country at the time of the meeting.

The first and second meetings were held in 1991 and 1992, immediately after Mongolia had begun the transition to a market economy and at a point when the country was facing a serious balance of payments crisis. Naturally, the most urgent topic of discussion at these first two meetings was how to resolve this crisis. Medium- and long-term development priorities were also discussed, but these talks were treated as complementary to those on the balance of payments crisis.

At the third meeting in 1993, the Mongolian economy was identified as being at a turning point, rebounding from economic contraction to growth, and the emphasis in the discussions began to shift from short-term responses to the balance of payments crisis to medium- and long-term development. This trend became more pronounced at the fourth meeting and is clearly evidenced in the World Bank pronouncement in its keynote report at the meeting: "[the Mongolian economy] has escaped from danger."

This optimistic outlook also prevailed at the fifth meeting, held in February 1996. What separated this meeting from the previous four, however, was a shift in emphasis from the economic infrastructure to the development of export-oriented business and small- and medium-sized enterprises. Moreover, ever greater priority was placed at this meeting on so-called "soft-type" assistance, involving the transfer of know-how in management, and monetary and fiscal administration.

These meetings are fundamentally forums for discussing basic orientations in assistance, and not for official discussions of specific coordination for individual assistance projects. However, insofar as they provide an opportunity for major donors to assemble in one place, they are invaluable as a venue for the exchange of information and discussions of individual projects at an unofficial level.

## **(2) Bilateral Assistance**

### **1) Japan**

#### **(1) Overview**

Japan's fundamental policy with respect to Mongolia's democratization and economic reform efforts, centering on the transition to a market economy, aims to actively

provide assistance, in both the bilateral and international contexts. From this perspective, Japan has utilized all available bilateral assistance schemes—grant assistance, technical cooperation, and yen loans—to extend assistance to Mongolia in a range of fields (agriculture, industry, social infrastructure, economic infrastructure, and human resources development). In addition, Japan has actively participated in or co-sponsored the five Mongolia Assistance Group Meetings and has played a leading role in lobbying the international community to provide assistance to Mongolia.

Japanese assistance to Mongolia can be traced back to 1977 when the country provided 5.1 billion yen in grant aid for the construction of a cashmere plant, but the scale of assistance was limited prior to 1990. Since 1991, when it stepped up its efforts, Japan has ranked as the leading donor of assistance to Mongolia through international organizations and bilateral channels, this assistance extending across all sectors (except that of macroeconomic coordination). Together with the World Bank, Japan has co-chaired the Mongolia Assistance Group Meetings.

At the fifth Mongolia Assistance Group Meeting, Japan pledged approximately 6.7 billion yen in assistance to Mongolia for FY1996.

## (2) Technical Cooperation

Japanese technical cooperation to Mongolia has grown rapidly since 1991, reaching 2.27 billion yen in 1994 and 2.34 billion yen in 1995. Japan began in the fall of 1994 to actively extend cooperation to Mongolia with a view to promoting the economic reform and supporting the human resources development that the country required, providing assistance for the transition to a market economy, in the spheres of economic reform and economic planning. Japan's assistance is being used to cultivate human resources and strengthen institutions to facilitate the full-scale operation of Mongolia's market economy.

Japan is accepting far greater numbers of trainees from, and sending many more experts to Mongolia, with the figures up to 1995 being 421 trainees and 126 experts respectively. Considerable developments are evident, including the conclusion of an agreement in 1991 to send Japan Overseas Cooperation Volunteers to Mongolia and the initiation in 1994 of project-type technical cooperation (Geology and Mining Resource Institute). Preliminary studies are scheduled for FY1996 for three new project-type technical cooperation projects: a plan to improve the diagnosis and prevention of livestock infection, a project to strengthen technical education at university level, and a project to improve

maternal-child health care.

At the local government level, JICA is working with Shariki-mura in Aomori Prefecture on a cooperative project in rice growing technology. Building on the record of cooperation at this level of government, experts in rice-growing (and vegetable-growing) technology were sent from Shariki-mura to Dornod *aimag* in 1995 and 1996. In addition, Chiba Prefecture is expected to cooperate with JICA in a maternal-child health care project.

Development studies were initiated in FY1990. By FY1994, 11 development studies had been conducted (three completed), and 11 were underway in 1995 (including three new studies). These studies cover a wide range of sectors, most notably the mining sector, and the agriculture, transportation, and communications sectors. JICA is seeking to emphasize organic linkages between Japanese grant aid, loan assistance, and other technical cooperation schemes, and giving priority to projects with excellent prospects of being self-profitable.

JICA is scheduled to conduct a development study in FY1996 aimed at developing Mongolia's abundant non-ferrous metal resources.<sup>18</sup>

### (3) Grant Aid

Japan has provided general grant aid primarily in the infrastructure-related fields of electric power and communications and the food supply sector. It has also extended food aid and assistance to boost food production, and since FY1991, grant assistance for grass-roots projects. With a view to enhancing living standards by improving the supply of hot water in the capital Ulaanbaatar, Japan extended assistance in FY1996 for the repair of the hot water supply facilities in Ulaanbaatar Power Station No. 4.

### (4) Loan Assistance

In the area of loan assistance (yen loans), Japan provided funds for a project to upgrade Mongolia's rail transport capacity in FY1993 and FY1994, and for the repair of Ulaanbaatar Power Station No. 4's boiler in FY1995. Japan provided a total of approximately 7.3 billion yen in commodity loans in FY1991 and FY1992.

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<sup>18</sup> Basic Study for Resource Development Cooperation in the Tsagaan Tsakhir Uul District.

## 2) Germany

In its assistance to Mongolia, Germany has placed an emphasis on four areas: economic reform (private-sector support), infrastructure-building (energy and telecommunications sectors), vocational training, and environmental conservation. It appears that Germany's prime objective is to implement technology transfers in their areas of strength--industry and the environment. While the scale of individual projects is generally small, since 1991 Germany has extended 160,600,000 DM (approximately \$94.5 million) in total ODA assistance. Assistance for small- and medium-sized enterprises has centered on technical assistance by extended-stay experts. Germany has provided equipment through a fund (6.5 million DM) administered by the Ministry of Trade and Industry. In FY1995 it provided 8 million DM (\$5.40 million) in technical cooperation, 5 million DM (\$3.40 million) for training of power plant employees, 20 million DM in small-scale two-step loans<sup>19</sup> to promote small and medium-sized enterprises, and 4 million DM in the health care sector. It has also sent extended-stay experts in small- and medium-sized enterprises to the Ministry of Agriculture and Industry.

## 3) United States

Assistance from the United States consists primarily of humanitarian and human resources assistance administered by USAID, major programs comprising the provision of spare parts for the energy sector (1992), the dispatch of English teachers, and food aid. Although the overall scale of U.S. assistance is small, its food aid consists chiefly of such necessities as wheat, butter, and cooking oil, and is consequently well-spread throughout the general populace. The \$2.8 million in counterpart funds from this food aid was used as a fund to foster small and medium-sized enterprises. At the Fifth Mongolia Assistance Group Meeting in February 1996, the United States expressed its intention to provide assistance primarily in the areas of economic reform, democratization, energy sector infrastructure, and food aid. USAID formerly maintained an office within the U.S. Embassy in Ulaanbaatar before its closure in September 1996.

## 4) Russia

Russian assistance to Mongolia as of April 1995 was as follows:

- In 1992, \$38.7 million in soft loans for energy/transportation projects.
- Provision of petroleum products (170,000 tons)
- Deferral of outstanding principal and interest payments (rescheduling of debts)

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<sup>19</sup>Total for KfWIII in 1994 and KfWIV in 1996. Amount does not include food aid counterpart funds.



falling due in 1991 through 1995 to the year 2000 and later) of 199 million rubles.<sup>20</sup>

All Russian assistance currently comes in the form of loans. Russia continues to be, needless to say, an important country for Mongolia in terms of securing trade routes and as a source of spare parts and oil. Resolving its debt problems with Russia is an extremely important issue which may have an impact on the entire Mongolian economy.

At the Fifth Mongolia Assistance Group Meeting, Russia expressed its intention to place emphasis on alleviating poverty, while also extending cooperation in the sphere of infrastructure development in the energy sector, including the upgrading of power station facilities.

#### 5) China

China, like Russia, will play an important role in getting Mongolian economic growth on track. China is currently strengthening its presence in commercial fields (service industries, trade), which is said to be causing increased wariness in the Mongolian government.

All assistance from China comes in the form of loans. China has provided a total of \$1.54 million in commodity loans and loans for the construction of factories making Chinese noodles, reinforced concrete, and paper.

#### 6) Other Donors

South Korea, India, and countries in Western Europe and Scandinavia also provide assistance, but the scale is limited.

### (3) Multilateral Organizations

Next, we will touch briefly on multilateral donors' major projects in priority fields in Mongolia (in order of assistance size).

#### 1) Asian Development Bank (ADB)

Among international organizations, the ADB is the largest donor to Mongolia. As of the end of 1995, it had extended approximately \$250 million in loans and \$25 million in technical cooperation. From 1996 through 1999, it plans to extend an average of \$60 million

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<sup>20</sup> Ruble-denominated debts to the former Soviet Union are expressed in dollars at the prevailing exchange rate at the time of providing the loan.

in assistance annually.

Changes in emphasis in the ADB's assistance to Mongolia, culled from ADB statements delivered at the Mongolia Assistance Group Meetings, the "Asian Development Bank Statement on Financing Plans," can be summed up as follows:

First meeting	Emergency assistance (construction equipment, industrial machinery spare parts, etc.)
Second meeting	Costs associated with the transition to a market economy; strengthening agricultural and industrial infrastructure
Third meeting	Enhancing assistance absorptive capacity; maintenance of reform and stabilization policies
Fourth meeting	Establishing the environment and developing human resources for the transition to a market economy; upgrading infrastructure
Fifth meeting	Macroeconomic stability; enhancing assistance absorptive capacity, strengthening reform in the agricultural sector

As this table indicates, the ADB's priorities have shifted from an initial strong emphasis on emergency assistance to more medium- and long-term and "soft-type" programs. The Bank's role among the donors is thought to lie mainly in cooperation for sector structural adjustment, sector master planning (especially infrastructure planning), and infrastructure creation and rehabilitation.

Assistance provided by the ADB to date for already-completed projects includes special balance of payments assistance (\$30 million), industrial sector program loans (\$30 million), and energy rehabilitation assistance (\$40 million). Meanwhile, projects currently underway or under consideration include assistance for the Egijn gol hydropower plant feasibility study (\$3.8 million), Ulaanbaatar airport (\$36 million), job creation (\$3 million), communications (digital network, \$24.5 million), and the Power Station No. 3 (amount unknown).

In FY1996, the ADB is scheduled to extend \$35 million in financial sector program loans and \$5 million in technical cooperation for human resources development in the energy and education sectors. From 1997 to 1999, it plans to provide assistance for electric power, road, health care, agricultural, and urban development.

The ADB does not maintain an office in Mongolia.

## 2) World Bank (IDA)

The World Bank co-chairs the Mongolia Assistance Group Meetings with Japan. Structural adjustment loans heads the list of priority areas for World Bank assistance, followed by project loans in the agriculture, mining, transportation, and tourism fields. The details are as follows.

1992	Economic recovery credits	\$30 million
1993	Economic transition assistance credits	\$20 million
1993	Structural adjustment credits	\$20 million
	Poverty alleviation credits	\$7 million
	Coal sector rehabilitation credits	\$20 million
	Total	\$97 million

In addition, the World Bank is currently preparing to extend assistance to the Ministry of Infrastructure Development as part of an urban public service rehabilitation project (scheduled to total \$15 million) focusing on water supply and sewage systems, waste processing, and public-sector institutional reforms.

The World Bank does not maintain an office in Mongolia.

## 3) International Monetary Fund (IMF)

The IMF has provided assistance to Mongolia on two occasions: it provided \$15.3 million under a 1991 stand-by agreement, and from 1993 to 1996 provided a three-year enhanced structural adjustment facility (ESAF) worth \$57.13 million. All of the 1991 funds have been disbursed, while the second year's portion of the ESAF is currently being disbursed. Along with the World Bank, the IMF has expressed the opinion that assistance for balance of payments support will have to be continued for at least two more years. The IMF maintains a liaison office within the Mongolian Ministry of Finance. In 1996, it is scheduled to provide \$25 million of assistance, which will be disbursed in three tranches.

## 4) United Nations Development Program (UNDP)

In addition to its own activities, the UNDP partially oversees those of other United Nations agencies (e.g., FAO, UNESCO, UNIDO, ILO) which do not have offices in Mongolia. The UNDP's own assistance to Mongolia focuses on the creation of frameworks for the Management Development Program (MDP) and the Poverty Alleviation Program (PAP). A large part of the UNDP's work consists of coordination, including the organization of

numerous donor workshops devoted to the topic of providing financial and human resources. For its own part, the UNDP provides only a limited amount of funds to Mongolia. On a contract basis it provided a total of \$16.7 million from 1990 to 1994 (calendar years). In the area of human resources development, it is currently implementing two programs through the Japan Human Development Trust Fund (a management education project and a practical training program in international trade [ASYCUDA]).

Together with the Mongolian Ministry of Nature and the Environment, the UNDP is also conducting bio-diversity studies and research through the Global Environment Facility, the World Bank's environmental trust fund.

The UNDP maintains its own office in Mongolia.

#### 5) European Union (EU)

The EU is providing assistance to Mongolia under the Technical Assistance for ex-CISs (TACIS) program. Under this program, financial assistance for democratization and the transition to a market economy is provided to countries of the former Soviet Union and Eastern Europe in order to support political freedom and promote economic growth. A total of 1,870 million ECU was invested in over 2,000 projects in all of the target countries together over the four-year span from 1991 through 1994 under this program.

The EU has the following five projects underway or planned in Mongolia.

- 1) Reinforcement of employment services; Started December 1994; 1.2 million ECU;  
(Labor policy assistance and creation of a network of employment centers in conjunction with the Ministry of Population Policy and Labor)
- 2) Economic education reforms; Started November 1994; 2 million ECU;  
(Assistance in the establishment of an organizational framework, and the provision of equipment and educational materials to the Mongolian Economics Institute)
- 3) Establishment of an educational information system;  
Started December 1994; 600,000 ECU;  
(Assistance for creation of an information system to link the Ministry of Science and Education with major universities via the Center for Scientific and Technological Information)

- 4) Assistance for small- and medium-sized enterprises, including agricultural product processing; Scheduled for 1995;  
(Plans call for small- and medium-sized enterprise (SMEs) policy assistance for the NDB; establishment of a Small- and Medium-sized Enterprise Development Agency; establishment of a Management Development Center with the UNDP as part of the Management Development Program; and human resources development for SMEs)
- 5) Improvement of Darkhan/Choibalsan energy facility capacities; Date to be confirmed; 1 million ECU;  
(Rehabilitation of the two cities' power plants and heat supply systems)

As shown here, the EU's assistance fields include some that are also the targets of future Japanese cooperation—human resources development, industrial assistance, and the energy sector—and therefore care will have to be taken to avoid duplication.

The EU has maintained its own office in Mongolia since 1995.

#### 6) Other Multilateral Donors

UNICEF, FAO, WHO, and UNFPA also provide assistance to Mongolia, as described below.

- 1) UNICEF: 1991-94 program; Child health care, infectious disease prevention, immunizations, maternal-child health care, etc.;  
Amount of assistance: approximately \$1 million
- 2) FAO: Agricultural statistics, veterinary training, livestock quality control, etc.;  
Approximately \$1.9 million
- 3) WHO: Technical assistance (pharmaceutical policy, etc.), emergency assistance;  
Approximately \$11.8 million
- 4) UNFPA: Enactment of population policy, assistance for population studies at the national university, improved welfare for women, maternal-child health care, promotion of family planning, etc.; Approximately \$3.8 million

#### **(4) Non-governmental Organizations**

One example of non-governmental organizations' activities in Mongolia is the First Mongolian Women's NGO Conference, held in Ulaanbaatar in October 1996. Over 400 women representing NGOs from *aimag* and *sum* throughout the country participated in the conference, as did Mongolian President Ochirbat. A decision has been made to continue this conference in coming years.